OMERS Sponsors Corporation

2017 Report to Sponsors

2017 Highlights

The interests of OMERS members, employers, sponsors and other stakeholders are represented by two corporations with separate and distinct mandates:

OMERS Sponsors Corporation (SC) provides strategic and risk oversight – as well as decision-making with regard to designing pension benefits, setting contribution levels, and determining the composition of the two OMERS Boards.

OMERS Administration Corporation (OAC) provides strategic, risk and operational management in serving Plan members and employers, collecting contributions and paying pensions, and investing the Plan funds.

This bicameral (two-part) structure provides for the effective operation of OMERS as a whole. Specifically, it helps to ensure broad input into decision-making by considering the interests of a large number of stakeholders – with focused expertise in key areas, including Plan design, member and employer service, and investments.

The two corporations and their Boards work together, closely and collaboratively, to meet a singular goal: the delivery of secure, sustainable and affordable pension benefits that address the needs of both members and employers.





2017 Highlights

94% Funded	**11.5%** Net Rate of Return	**$95** Billion in Net Assets	**482,000** Members
$4.0 Billion in Contributions	**$4.0** Billion in Pension Payments	**984** Employers	**35+** participating unions and associations




Protecting the Promise – OMERS in a changing world

From a Plan design perspective, the stated mandate of the OMERS Sponsors Corporation is simple enough: to determine, through informed decision-making and strong governance practices, the benefit and contribution levels for the OMERS Plans. Again, the ultimate goal is to ensure that OMERS remains sustainable, meaningful and affordable for both members and employers for generations to come.

That's a huge obligation (and challenge) when you consider that defined benefit (DB) pension plans provide "guaranteed" lifetime benefits based on uncertain assumptions about future events. While OMERS continues to enjoy considerable financial success in the short term, we are still recovering from the 2008 financial crisis. There is also an acute awareness that the good times won't last forever – and that the Plan, like all DB plans, faces some very real but surmountable challenges over the longer term.

Given the emerging realities, the SC Board took a number of important and strategic steps in 2017 to strengthen our management team and lay the foundation for possible future change. Among other things, the SC:

- Co-sponsored two key research projects with the OAC – one to assess the impact that an evolving workforce could have on future OMERS membership, and one to measure the social value of the OMERS Plan, specifically, the value of our Plan for our communities.

The ultimate goal is to ensure that OMERS remains sustainable, meaningful and affordable for both members and employers for generations to come.

FRANK RAMAGNANO
Board Co-Chair,
OMERS Sponsors Corporation

The SC Board took a number of important and strategic steps in 2017 to strengthen our management team and lay the foundation for possible future change.

MARIANNE LOVE
Board Co-Chair,
OMERS Sponsors Corporation

Protecting the Promise

- Unanimously approved subtle yet important Plan amendments – as part of the standard SC Plan Change Process – designed to promote fairness and streamline Plan administration.
- Improved our standard communication processes, and engaged more regularly and effectively with Plan sponsors, key stakeholders and other constituents.
- Improved governance practices related to the nomination, appointment, and reappointment of both OAC and SC Directors.
- Launched a formal consultation program with sponsors to review the potential introduction of Modified Inflation Indexing (MI^2).
- Thanks largely to the feedback provided by stakeholders during the MI^2 consultation, launched a formal Comprehensive Plan Review designed to assess the Plan's long-term financial health – and to ensure the sustainability of the Plan over the longer term.

We are extremely pleased with the progress we've made over the past 12 months. We are equally exhilarated by the important work that lies ahead. It has been a busy and productive year for the SC – and OMERS as a whole. We look forward to working with each of our sponsors and key stakeholders to make 2018 an equally successful year.

The conversations we are having now will set the course for the next 20, 50 and even 100 years for our Plan. It's all about preserving the pension promise for generations to come.

PAUL HARRIETHA
Chief Executive Officer,
OMERS Sponsors Corporation

The Plan, like all DB plans, faces some very real but surmountable challenges over the longer term.

CHRIS VANDEN HAAK
Vice President, Pension Governance & Strategy,
OMERS Sponsors Corporation

Leading Informed Change – A focus on good governance

As clichéd as it may sound, change remains a significant constant at OMERS. Over the past 50 years, the OMERS Plans have evolved to address things like changing member needs, economic realities, regulatory and legislative updates, and evolving social and workplace trends.

Recognizing that the decisions made at the SC Board table can impact hundreds of thousands of Ontario residents across generations, the approval of Plan changes is never taken lightly or left to chance. The adoption of new contribution and/or benefit levels is informed by a formal Funding Management Strategy (FMS) – and governed by a disciplined annual Plan Change Process that gives due consideration to differing viewpoints and interests.

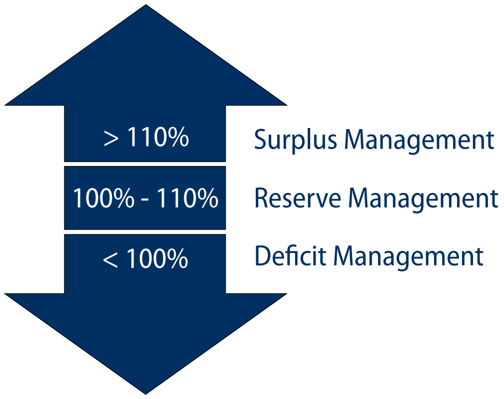
It's about anticipating trends and providing sustainable pensions – across generations – based on some conservative assumptions about future events. Put another way, it's about preserving the pension promise over the next 20, 50 and even 100 years, without favouring one generation over another.

Given improving life expectancies, after all, it is not inconceivable that a 20-year-old who joins the Plan today could be alive, well and collecting an OMERS pension in 2118. That is a challenge that requires constant vigilance, and a disciplined and conservative approach to Plan funding and management.

The Funding Management Strategy

Plan sustainability is managed, in large part, through the SC's Funding Management Strategy: a formal framework that informs how and when benefits and/or contribution rates will change based on the Plan's financial health.

Under the current FMS, the Plan remains in the Deficit Management Zone, which means that the Plan's funded ratio is less than 100%. Within this zone, the primary focus is to return the Plan to full funding, typically through contribution increases, benefit reductions, or some combination of the two.



Thanks in large part to a disciplined investment strategy, an extended bull market, and additional contributions from both members and employers, the financial health of the OMERS Plan continues to improve in the short term. Assuming all goes consistently well, the Plan is projected to be fully funded by 2025, if not sooner.

Given this improved financial position and positive short-term outlook, the SC elected in 2017 not to impose changes under the terms of the FMS. The Board was satisfied that current contribution levels will satisfy regulatory requirements until the end of 2020.

Leading Informed Change – Other Plan Changes

In 2017, the Board elected to make changes in three areas of the OMERS Primary Plan under its standard annual Plan Change Process. Subtle but important changes were approved at the Board's meeting on June 21, 2017, as summarized in the table below.

The first two areas, relating to commuted values (CVs) and pension commencement, will limit the use of certain provisions that could give a few Plan members an unintended benefit at the expense of the entire membership. The third area allows employers to avoid undue expenses related to providing a Canadian pension plan in a foreign state. A final technical amendment was made to amend the language in the Plan relating to AVCs. There was no member impact from this change.

From our perspective, the changes are balanced and fair to all members and employers, including those who may be directly impacted by the changes.

1

Commuted values and buy-backs

From our perspective, the changes are balanced and fair to all members and employers, including those who may be directly impacted by the changes.

There are two new restrictions related to commuted values:

- Members who are eligible to choose a commuted value (CV) when they leave an OMERS employer must make that choice within six (6) months after terminating their employment (or by January 1, 2020, if later)
- Members will now have to wait five (5) years before they can buy back a period of eligible service for which they previously received a CV from OMERS.

2

Dual members

Members will no longer be able to receive an OMERS pension while continuing to work full time with an OMERS employer. This change applies to members who have more than one OMERS employment position (dual members), where at least one of those is a full time position. To give members adequate time to review their current employment status and retirement plans, this change will take full effect as of January 1, 2020.

3

Foreign service members

Starting August 23, 2017, OMERS employers will have the option to suspend participation in OMERS for those employees who are employed outside of Canada. Employers who make such an election will determine the appropriate transition for their affected employees.



Leading Informed Change – Assessing OMERS Social Impact

Beyond enhanced financial security, just how important is OMERS to members and their communities? To help answer this fundamental question, the SC teamed with the OAC in 2017 to assess the social value of the OMERS Plan – and, more specifically, the value of our Plan for our communities.

The study compared the attitudes and behaviours of OMERS members who are retired (or near retirement) with retirees who do not belong to a defined benefit pension plan. The goal was to understand if greater certainty of retirement income generates social value for communities and governments.

The study focused on four drivers of social value: management of health, community engagement, financial stability and self-reliance.

At the very least, the study confirms the importance of preserving (and, ideally, expanding) coverage under DB pension plans in Ontario – and the OMERS Plan, in particular.

In addition to the social value created by OMERS members in the community, there is also positive economic value created by the Plan with the impact of benefit payments, investments and job creation. In particular, $4 billion in annual pension payments supports retirement security; taxes paid on pension income help to fund government priorities; and OMERS investments in companies helps to create jobs.

The key highlights of the study findings include:

OMERS members feel healthier overall and stay more physically active in retirement.

OMERS members are more active community participants and help others in need, donate more often to charity, and volunteer more.

OMERS members are more confident about their retirement savings and about their ability to handle unexpected expenses.

They also feel more confident about their ability to look after themselves and their families financially, and are less reliant on government financial support.

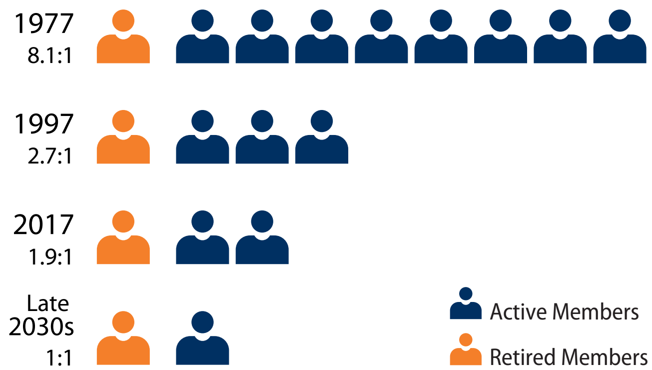
Leading Informed Change – Workforce Evolution

To help inform the SC's consideration, including proposed mandatory participation for non-full-time employees in OMERS, the SC also teamed with the OAC and experts from Deloitte to conduct a robust *Membership Evolution Study*. The study considered the potential impact that key disruptors – such as technology, artificial intelligence, the emerging gig economy, and evolving fiscal pressures – could have on future employment patterns in Ontario and, by extension, OMERS membership.

Among other things, the study concludes that OMERS active membership is likely to shrink over the next 25 years – and potentially dramatically under certain scenarios. Even under the best-case scenario, it is projected that membership growth will slow over the longer term, which could have a material impact on Plan maturity (the ratio of active to retired members) and, by extension, OMERS capacity to fund future pension promises.

Looking forward, the OMERS Plan will continue to mature. In 2017, the ratio of active members to retired members stood at 1.9:1, which compares with a ratio of 2.7:1 just 20 years ago. It is expected that the ratio of active to retired members will reach 1:1 in the 2030s – and it could drop below 1:1 if our membership shrinks. As the Plan matures, it becomes more vulnerable to stresses, as there are relatively fewer members to absorb the cost of any negative events.

The steady maturation of the Plan, combined with very real potential of a declining membership, are two of the key realities that have prompted the SC to conduct its Comprehensive Plan Review (see pages 13 and 14 for more details).



Sponsors Corporation Board Members

Marianne Love,
Board Co-Chair
Association of Municipalities of Ontario

Frank Ramagnano,
Board Co-Chair
Ontario Professional Fire Fighters Association

Dan Axford
Police Association of Ontario

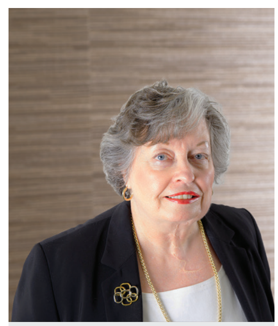
Paul Bailey
Police Pensioners Association of Ontario

Frederick Biro
Ontario Association of Police Services Boards

Barry Brown
Association of Municipalities of Ontario

Diana Clarke
Ontario Public Service Employees Union

Peter Derochie
Ontario Catholic School Trustees' Association



Mary McConville
Ontario Association of Children's Aid Societies

Charlie Macaluso
Electricity Distributors Association

Tim Maguire
Canadian Union of Public Employees

Joe Pennachetti
City of Toronto

Sandra Sahli
Ontario Secondary School Teachers' Federation

John Weatherup
Canadian Union of Public Employees

Leading Governance – A focus on governance best practices

As one of Canada's largest defined benefit pension plans, OMERS is a complex organization with a substantial mandate to manage more than $95 billion dollars on behalf of more than 480,000 active and retired members. The ability to deliver on this essential obligation depends largely on the quality of the OMERS governance structure, the effectiveness of the individual members of the OAC Board, and how well they function as a team.

In this context, the SC is keenly focused on appointing individuals who will produce a high-functioning Board – this is, a Board that has the attributes and competencies required to oversee an organization of the size and complexity of the OMERS Administration Corporation.

To help clarify and streamline this essential nomination process, and support the decision-making of individual sponsors, the SC Board:

- Approved an accelerated nomination and appointment process in 2017 that separates the nominations and appointment of incumbent Directors from those individuals being nominated to the OAC Board for the first time.
- Worked with the OAC to develop an updated Competency Framework and new Skills Matrix to better assess the Board's strengths and needs from an appointment perspective.

These enhanced policies and practices will be adopted fully in 2018, and will be monitored regularly and updated as appropriate to ensure effectiveness. We are, as always, committed to continuous improvement – and meeting the needs of our sponsors, stakeholders, unions, employers, members and other beneficiaries.

In 2017, the SC Board appointed Yung Wu, a nominee from the Police Association of Ontario, effective January 1, 2018. Mr. Wu is a member of the Investment Committee and the Technology Committee. The Board also approved the reappointment of three incumbent Directors to three-year terms beginning January 1, 2018:

OAC Board Directors	Organizations	OAC Committees
Cliff Inskip	Ontario Public School Boards' Association (OPSBA)/ Ontario Catholic School Trustees' Association (OCSTA)	• Audit & Actuarial • Investment Committee • Risk Oversight
Monty Baker	Ontario Association of Police Services Board (OAPSB)	• Audit & Actuarial • Technology
Charlene Mueller	Canadian Union of Public Employees (CUPE)	• Audit & Actuarial • Technology

Looking Ahead – the Comprehensive Plan Review

Despite recent financial success and a generally positive outlook, there is a strong consensus that OMERS – like most major defined benefit pension plans globally – faces some very real longer-term challenges that warrant serious consideration.

These realities include a steadily maturing plan; longer life expectancy; changing demographic and workplace trends; an increasingly uncertain economic environment; and recent regulatory and legislative developments, including Canada Pension Plan (CPP) enhancements.

Recognizing these challenges, the SC Board has been working over the past number of years to assess ways to manage the Plan's future financial health – while recognizing the differing needs and expectations of various stakeholders, including members. This robust and ongoing analysis culminated in 2016 with the proposed development of Modified Inflation Indexing (MI^2), an innovative approach to conditional indexing that would give the SC greater flexibility to manage future funding risks.

Given the importance and scope of this potential Plan change, the SC engaged directly with key sponsor representatives early in 2017 to gauge their perceptions of the MI^2 concept. While response to the MI^2 concept was generally positive (subject to a fuller understanding of how MI^2 would work in practice), a couple of sponsors opposed the concept as presented. These and other sponsors also challenged the SC to fully explore *all of the alternatives* for managing the Plan's future financial health.

In direct response to essential feedback, the Board agreed to revisit the full suite of potential risk-mitigation strategies that it has assessed over the past few years – and to consider alternative options, as appropriate. In September, it resolved to undertake a Comprehensive Plan Review to ensure the sustainability of the Plan over the longer term.

The SC retained an independent actuarial adviser in September to conduct a comprehensive assessment of the OMERS Plan using advanced systems and software applications. Their robust modelling clearly confirms that, given the outlined challenges, there is a strong likelihood that the cost of the existing Plan design will increase beyond current levels – and well beyond under certain scenarios. Put another way, future OMERS members could end up paying more for less if adjustments aren't made.

As a next step, the Board will consider the long-term impact of various benefit and contribution options, including revisions to the FMS. In keeping with the timelines established for the OMERS SC Plan Change Process, the Board will vote on any proposed changes at its June meeting. As always, approved changes require a two-thirds majority vote.



Looking Ahead

Here are five key factors that are driving the Comprehensive Plan Review:

Plan Maturity

The OMERS Plan is aging. In 1977, the ratio of active members to pensioners was almost 8.1:1. At the end of 2017, that ratio was 1.9:1. It's expected that the ratio will stabilize at about 1:1 by the late 2030s, assuming that our active population grows by 1% per year.

With fewer contributing members to make up for potential investment losses, mature plans are more vulnerable to economic downturns. A funding deficit will consume a greater portion of our members' take-home pay in the future than it has in the past, and a greater proportion of their employers' payroll.

In addition, we can expect to pay more out in pensions each year than we take in through contributions. While our investment income is intended to cover the difference, negative cash flow leaves our investment teams with less flexibility to generate positive returns – particularly when dealing with a downside event, such as an economic downturn.

Longevity

OMERS members are living longer. Life expectancy has increased steadily by two to three years every decade since 1900 and is expected to increase in the future. That's obviously a very good thing from the individual member's perspective. But it does put additional pressures on the Plan.

If people live five years longer, they actually increase the expected duration of their retirement by 20% or more. With an additional 60 monthly pension payments, retirement becomes a much more expensive proposition – and more rewarding given increasing vitality. The result is increased Plan liabilities and, by extension, higher Plan costs. There is no way around it.

Not only are people living longer, a growing number of members are joining the Plan at older ages (age 37, on average). Obviously, living longer and starting work later calls into question the need for subsidized early retirement benefits, as well as the appropriateness of the current normal retirement date. Short working lives and long retirements are conceptually appealing but financially challenging.



Looking Ahead

Economic Factors

The OMERS Plan has posted strong investment returns in recent years. By all indications, it is going to be extremely difficult to generate consistently high returns over the longer term.

As developed countries age, their economic growth is likely to decrease, hampering investment returns and placing far greater pressure on contributions to sustain the Plan's financial health. All of which suggests that our funding and investment strategies will need to evolve in the future.

Over the long lifecycle of a pension plan, future economic downturns are inevitable – which, given the various realities already noted, poses a real threat to the Plan's long-term sustainability.

Workforce Trends

How will factors like automation, privatization and alternative forms of employment impact OMERS in the future? A recent *Membership Evolution Study* confirms that OMERS active membership is likely to shrink over the next 25 years – and potentially dramatically, under certain scenarios.

Declining membership intensifies the maturity challenges described above. It also suggests that we should be actively looking to expand membership where we can, including broader participation for non-full-time employees under appropriate circumstances. Add realities like the emerging gig economy and the millennials' apparent preference for less permanent forms of work, and the future membership picture and evolving retirement needs get even more complex.

CPP Enhancement

Starting in 2019, the Canada Pension Plan (CPP) will be gradually enhanced, with contribution rates increasing in stages over seven years. CPP enhancement will increase benefits for members – raising the income replacement rate from 25% to 33% of average earnings – and the maximum limit used to determine average work earnings will also gradually increase by 14% by 2025. For those at the maximum, the CPP benefit will ultimately increase by approximately 50%. And contributions (employer and member) will jump by just over $800 each, in current dollar terms.

This raises some key questions. If more employment dollars are directed to securing retirement income outside of the OMERS Plan, are the current OMERS benefit formula and corresponding contribution rates still appropriate? Will OMERS members end up over-saving for retirement during their working years – and reduce their net take-home pay unnecessarily in the process? More fundamentally, has integration with CPP been a success?

OMERS Sponsors Corporation

OMERS Annual Meeting

Monday, April 9, 2018
9 a.m.-11a.m. EST (light breakfast at 8:30 a.m.)

Metro Toronto Convention Centre
North Building, Level 100, Room 105
255 Front Street West, Toronto, ON

Public parking available

Register for video webcast
Visit omers.com
or omerssc.com

Contact Us

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Paul Harrietha
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