OMERS Update on Supplemental Plans: Generic Information

At a stakeholder meeting with OMERS (September 23, 2005), a representative of Watson Wyatt, the actuary for OMERS, made a presentation outlining possible costs for various supplemental plans that could be possible under Bill 206. The presentation, including speakers' notes, can be downloaded from our website.

The information in the presentation and in this E-Bulletin should be treated with caution as it is very preliminary and built on a multitude of assumptions about the supplemental benefits that might be offered, their design, the demographic profile of groups adopting such benefits and fund performance and market conditions.

Supplemental Plans

Under Bill 206, the current OMERS plan will continue as the "Primary Pension Plan." Bill 206 also provides for additional plans to be added, called supplemental plans, if approved by the Sponsor Corporation and adopted in localities through the collective bargaining process. The supplemental plans are to be stand alone plans with no cross-subsidy with the Primary Plan. Supplemental Plans might be offered to police and fire employees who have a normal retirement age of 60 or others who have a normal retirement age of 65.

Possible Supplemental Benefits

To determine the range of costs for possible benefits that members might seek, OMERS identified a number of benefits that could be of interest to members. There could be other benefits that could be identified. As noted above, no benefit will be available unless approved by the Sponsor Corporation (established under Bill 206) and agreed to through collectively bargaining locally.

OMERS identified 10 possible benefits for the NRA 60 group and 8 for the NRA 65 group (benefits 8 and 9 below are only applicable to NRA 60 employees).

	Normal Retirement Age (NRA) 60	Normal Retirement Age (NRA) 65
1	2.5% reduction per year for early retirement. Current reduction is 5.0%	2.5% reduction per year for early retirement. Current reduction is 5.0%
2	80 Factor, up to 10 years before NRA. (Service and age add to 80, but cannot retire before 50 years of age on unreduced pension, i.e. NRA – 10)	85 Factor, up to 10 years before NRA. (Service and age add to 85, but cannot retire before 55 years of age on unreduced pension, i.e. NRA – 10).
3	80 Factor, up to 10 years before NRA. (Service and age add to 80, but cannot retire before 45 years of age on unreduced pension, i.e. NRA – 15)	85 Factor, up to 15 years before NRA. (Service and age add to 85, but cannot retire before 50 years of age on unreduced pension, i.e. NRA – 15)
4	75 Factor, up to 10 years before NRA. (Service and age add to 75, but cannot retire before 50 years of age on unreduced pension, i.e. NRA – 10)	80 Factor, up to 10 years before NRA. (Service and age add to 80, but cannot retire before 55 years of age on unreduced pension, i.e. NRA – 10)
5	75 Factor, up to 15 years before NRA. (Service and age add to 75, but cannot retire before 45 years of age on unreduced pension, i.e. NRA – 15)	80 Factor, up to 15 years before NRA. (Service and age add to 80, but cannot retire before 50 years of age on unreduced pension, i.e. NRA – 15)
6	25 and out, no age limit	30 and out, no age limit
7	0.6% integration with CPP. (Reduction of CPP claw-back which is currently 0.675%)	0.6% integration with CPP. (Reduction of CCP claw-back which is currently 0.675%)
8	2.33% Accrual (Future Service Only).	Applicable to NRA 60 only

	(Higher accrual rate. Current rate is 2.00%).	
9	2.33% Accrual (Past and Future Service) . Note currently permitted under Bill 206	Applicable to NRA 60 only
10	Final 3 Year Average Earnings. (Generally higher average earnings. Currently OMERS benefits are averaged over 5 years)	Final 3 Year Average Earnings. (Generally higher average earnings. Currently OMERS benefits are averaged over 5 years)

These benefits are costed individually, but could be offered in combination if approved by the Sponsor Corporation and negotiated through local bargaining units. It should be noted that in deriving costs for these benefits, the analysis assumed a demographic profile that mirrors the profile of the overall OMERS membership. Costs for specific groups who choose to adopt these benefits could differ if their group profile differs materially from the demographic profile of the overall membership. Costs could be higher, for example, if a group's average age is higher than the overall average.

Costing the Benefits
The presentation on benefit costs given at the stakeholder meeting identified four types of costs:

<u>Going Concern Costs (Past Service)</u>: Costs associated with paying the benefit for past service. These costs must be financed over a 15 year period.

<u>Going Concern Costs (Future Service)</u>: Costs to finance the benefit into the future without regard to past service.

<u>Solvency Costs</u>: The *Pension Benefits Act* (Ontario) and regulation sets out formulas for calculating solvency requirements for a pension fund. Solvency costs are the costs to settle all plan benefits if the plan winds up. A solvency deficiency must be financed in no more than 5 years. In the various costing examples presented, solvency requirements are often significant given the assumption that benefits would apply to past service. Extending benefits to past service means that significant payments are needed in the first five years to ensure that the plan could meet its liabilities if wound up.

Solvency calculations assume retirement at the most financially advantageous age. This differs from going concern costs that assumes that members retire at their normal retirement age.

OMERS has argued in the past that the OMERS plan should be exempt from solvency requirements. It is unlikely that this large public plan would be wound up or terminated the way that a private sector plan might be. Future benefit costs could be eliminated or significantly reduced if the OMERS plan is exempted from solvency requirements. In the absence of such an exemption, solvency costs can be reduced by not including past service when creating new benefits.

<u>Rebound Costs</u>

As a result of offering supplemental plans, members may decide to retire earlier than they would in the absence of the supplemental plan. This early retirement will have impacts on the primary OMERS plan since there will be a reduction in contributions to the primary plan. Given the principle that there should be no cross subsidy between the primary plan and supplemental plans, these "rebound costs" have been allocated to the supplemental plan.

Costing Assumptions

- In each case the benefits were assumed to apply fully to past service, with the exception of the 2.33% accrual rate for NRA 60 members. Extending this accrual rate to past service is prohibited under Bill 206. (Although Option 9 for NRA 60 shows the cost of increasing the accrual rate to 2.33% for past service for information purposes).

- Members of supplemental plans are assumed to have the same demographic profile as the existing primary plan. Actual costs for supplemental plans will, therefore, differ from those shown here if the demographics of the group receiving the supplemental plan differ from the overall profile.

- There is no cross subsidization between supplemental plans and the primary plan.

- Future service costs are assumed to be pooled.

Analysis

The presentation give at the stakeholder meeting shows:

- 18 possible benefits that might be considered for supplemental plans and their cost expressed as a percentage increase over current costs.
- Examples are given of the impact on:
    - An NRA 60 employee for 1 option (option 4)
    - An NRA 65 employee for 1 option (option 6)
    - An employer with both types of employees (for same options as above)

In addition, MFOA has taken the methodology used to calculate costs to the employee to calculate increased costs for all 18 options. You can download the spreadsheet to see these costs. It should be noted that since the costs of both the Primary Plan and the supplemental plans are shared on a 50/50 basis between employees and employers, a given percentage increase for an employee will also be absorbed by the employer. For example, the OMERS slide presentation shows a 43% increase in costs for an NRA 60 employee receiving option 4 (75 Factor, up to 10 years before NRA). In the analysis of the employer impact, the cost for this benefit to this group in the first 5 years is the same 43%.

Follow this link for MFOA's summary of:

- benefit costing by option (see above)
- examples of these costs to an NRA 60 and NRA 65 employee, and
- employer impacts of extending option 4 to NRA 60 and option 6 to NRA 65

Observations

Benefits Can Be Costly

- Initial costs for several benefits can be quite costly for both employers and employees. Obviously, costs are even greater if benefit packages are created that combine 2 or more of the benefits shown in the examples.

- Benefits could be even more costly for employers if the 2.33% accrual rate is extended to ambulance workers and paramedics.

- Costs could be reduced if OMERS is exempted from solvency requirements under the Pension Benefits Act (Ontario).

- Increases shown are somewhat understated since they are based on proposed 2006 contribution rates and not on actual 2005 contribution rates

- Municipalities might also experience other cost increases related to OMERS changes such as increased liabilities for post employment benefits. These are not factored into the OMERS analysis.

Plan Will Be More Complex

- The number of combinations and permutations of benefits under Bill 206 is significant. This will create new levels of complexity and could create portability issues.

Plan Will Have Higher Administration Costs

- The greater level of complexity will likely lead to increased costs for plan administration.