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OMERS in a changing world

OMERS SC announces a Comprehensive Plan Review

Running a major defined benefit (DB) pension plan is a complex task motivated by a simple goal: to deliver meaningful and affordable pension benefits on a sustainable basis. It's about managing the present with a keen eye on the future.

The immediate goal at OMERS is to return the Primary Plan to full funding. Since the economic crisis in 2008, the Plan's funded status has climbed steadily from 85.6% at the end of 2012, to 94% at the end of 2017. Assuming all goes well, the expectation is that the Plan will be fully funded by 2025.

It's a good news story. But it's only a single important chapter in an ongoing narrative. Looking forward, we have a wonderful opportunity (and obligation, as Plan stewards) to rethink the OMERS Plan – and to ensure that it remains *sustainable, meaningful and affordable* in light of today's complex and fast-changing world.

With the future firmly in mind, the SC Board resolved unanimously to launch a Comprehensive Plan Review. An extension of the Board's mandate to ensure the long-term viability of the Plan, this review will help us:

- model the Plan's long-term financial health;
- fully assess what members, unions, employers and sponsors really want and need from the OMERS Plan – today and in the future; and
- find ways to balance these objectives.

We are excited about the initiative, and look forward to engaging directly with stakeholders throughout the process. In the meantime, we invite you to read this bulletin carefully. As you will see, it provides a quick overview of a number of key issues and opportunities that continue to influence our thinking.

OMERS | Sponsors Corporation

A work in progress

OMERS and a tradition of prudent change

Change is a 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. Again, it's all about keeping OMERS a *meaningful, affordable and, ultimately, sustainable* DB pension plan over time.

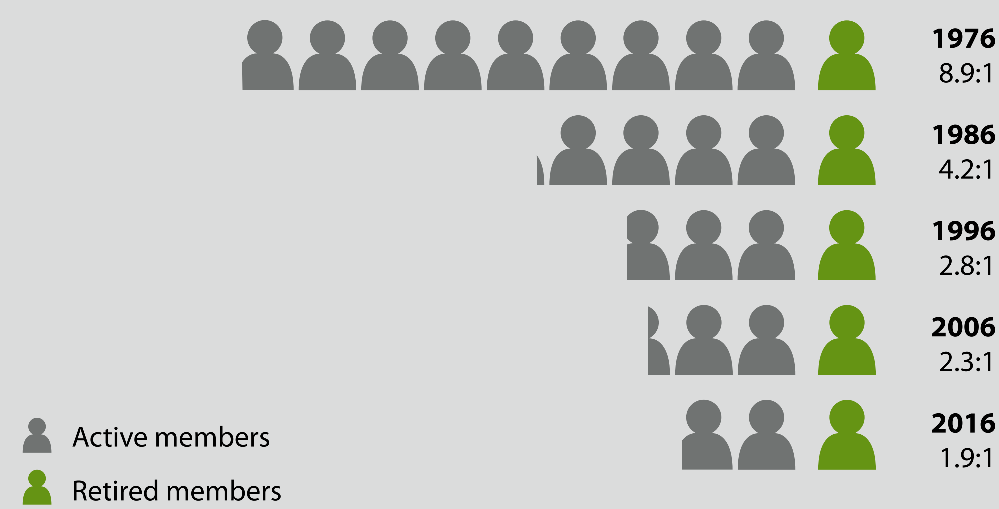
The Comprehensive Plan Review is a logical extension of this commitment to change – and one of the SC Board's primary obligations under the OMERS governance structure. Simply put, it is an opportunity to evaluate the OMERS Plan in response to a number of realities that are largely beyond our immediate control. Here are five key factors that the SC needs to consider when assessing the Plan:

Plan Maturity – The OMERS Plan is aging. In 1976, the ratio of active members to pensioners was almost 9:1. At the end of 2016, 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.

Active versus retired members – 1976-2016



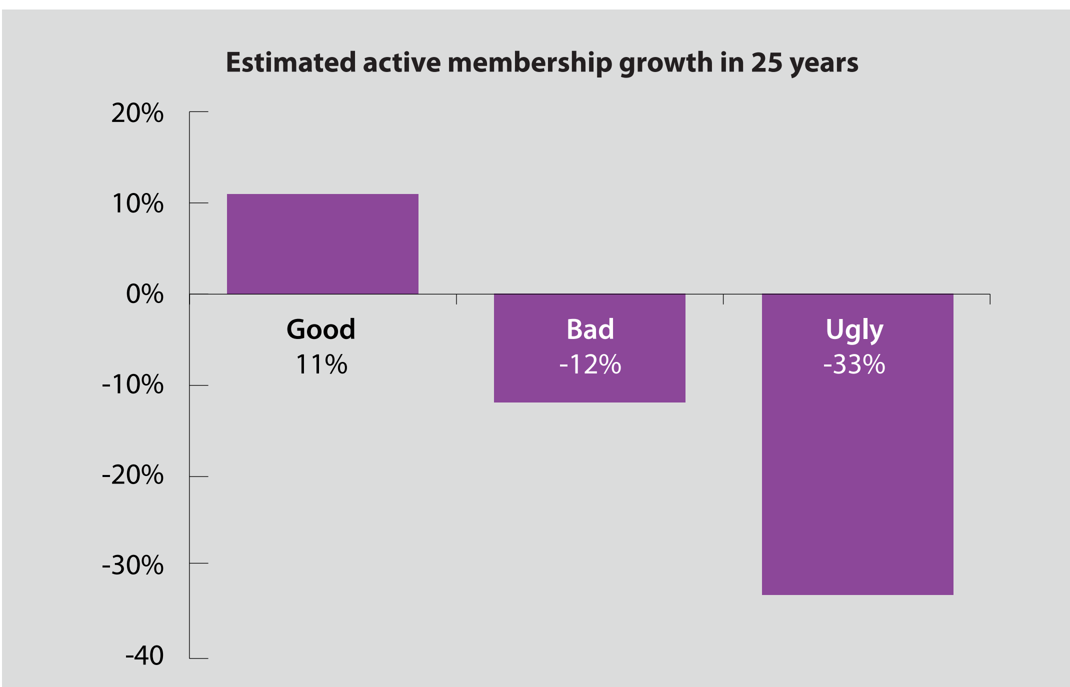
Longevity – OMERS members are living longer. Life expectancy has increased steadily by two to three years every decade since 1900 and is expected to increase in the future. That's obviously a very good thing from the individual member's perspective. But it does put additional pressures on the Plan.

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.

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.



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

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 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

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These are just a few of the challenges that we will explore and model in the months ahead. They are also opportunities – and the impetus for us to conduct a Comprehensive Plan Review. Again, it's all about ensuring that the OMERS Plan remains sustainable, meaningful and affordable for generations to come. That is our goal – and our commitment to Plan sponsors, unions, employers, members and beneficiaries.