Toronto Transit Commission Pension Fund Society (TTCPFS) - Analysis of Options With Respect to the TTC Pension Fund Society and OMERS

SUMMARY

This report summarizes the outcome of a preliminary analysis of 3 options with respect to the Ontario Municipal Employees Retirement System (OMERS).

The options under discussion were:

1) Full merger of the TTCPFS with the OMERS Pension Plan,
2) Investment Management of some or all of the assets of the TTCPFS by OMERS Investment Management (OIM), and
3) Provision of pension payroll and Member services by OMERS.

RECOMMENDATION

The Government Management Committee receive this report for information.

Financial Impact

There is no direct impact on the City of Toronto.

The conversion of the TTCPFS to a Jointly Sponsored Pension Plan (JSPP) was a pre-requisite for solvency funding relief from the Province. Absent this relief, the TTC and its employees were faced with the requirement to fund an additional $426 million of solvency liabilities as at January 1, 2011. The cost of funding this $426 million of increased liabilities, over 10 years, would have resulted in substantial contribution increases being borne by the TTC and its employees. In July of 2011, subsequent to the conversion of the TTCPFS to a JSPP, the Province has granted solvency funding exemption to the TTCPFS effective January 1, 2011, effectively removing the need for the above-mentioned, substantial, contribution increases.

As the TTCPFS is currently fully funded on a going concern basis, current contribution levels are expected to be adequate to meet the needs of the Society.

DECISION HISTORY

At its meeting of May 17-19, 2011, City Council adopted the following Government Management Committee recommendations with respect to report GM3.9 titled "City Sponsored Pre-OMERS Pension Plans and the Toronto Transit Commission (TTC) Pension Fund Society":

1. City Council request OMERS to work with the Treasurer to commence a gap analysis on regulatory, policy and actuarial aspects of information provided by City staff on the five City-Sponsored Pre-OMERS Pension Plans.

2. The Treasurer, working co-operatively with OMERS staff, report back to the September 15, 2011, meeting of the Government Management Committee with detailed options with respect to alternative investment management and pension administration of the five (5) City-Sponsored pre-OMERS Pension Plans.

3. The Chief General Manager of the Toronto Transit Commission (TTC), working co-operatively with OMERS staff, and under the direction of the TTC, develop a detailed work plan outlining an evaluation of options available to the TTC Pension Fund Society and report back to the September 15, 2011 meeting of the Government Management Committee.

4. In order to save time and external fees, both the Treasurer and the TTC Pension Fund Society staff meet with OMERS staff concerning their respective reports to City Council on what aspects of the current evaluation process outlined in the report (April 13, 2011) from the Treasurer require further review by external advisors and what can be formulated as joint/mutual positions to be addressed with the Province of Ontario or its agencies in advance of pending regulations.

5. City Council further direct that all relevant information identified by OMERS staff be provided in order to assist all the parties in completing a Work Plan of said analysis to the June 28, 2011 meeting of the Government Management Committee in order to evaluate the progress of this important initiative.

At its meeting of June 28, 2011, the Government Management Committee received a staff report outlining a work plan with respect to the evaluation of three (3) options related to OMERS providing alternative pension investment, administration and /or management services for the City's Pre-OMERS pension plans (re: GM5.2 titled "City Sponsored Pre-OMERS Pension Plans and the Toronto Transit Commission (TTC) Pension Fund Society – Work Plans").

ISSUE BACKGROUND

The TTCPFS was established pursuant to a collective agreement on January 3, 1940. The plan was created as a corporation and separate legal entity from the TTC. The TTC and the Amalgamated Transit Union – Local 113 (ATU 113), are co-sponsors of the TTCPFS. The TTCPFS, unlike the five Pre-OMERS City Plans is an active Pension Plan with 12,584 active Members and 6,307 Pensioners as of December 31, 2010, (a total of 18,891 Members).

As provided in the Bylaws of the Society, the Society's affairs are managed by a Board of 10 Directors, 5 of whom are appointed by the TTC, and 5 of whom are appointed by ATU 113. Board Membership is restricted to regular members of the Society. Any proposal to effect an outsourcing of Society plan administration and/or investment services, or to effect a merger of the Society and its fund with any other pension plan, could only be accomplished through valid Bylaw amendments initiated, implemented and approved by the Society Board and members (with TTC sanction) in accordance with Bylaw 3.09, including the applicable requirements of s. 3.09(iv). In considering any such proposal, Board members would be acting in their fiduciary capacity in connection with Society administration.

With the exception of Bylaw changes and contribution levels, the Board is solely responsible for all aspects of the operation of the Pension Plan. The Board is responsible for setting the asset mix, monitoring investment managers (selection, hiring, monitoring, and firing) and meeting all the legislative requirements of a registered pension plan.

All Bylaw amendments, including updating the base-period used to calculate pension entitlements and indexing of pensions in payment, are discussed and passed by the Board of Directors. Such Bylaw amendments are then brought to the Commission, usually shortly before the Annual General Meeting of the Society, for sanctioning and must be approved by the Membership at the Annual General Meeting of the Society.

Contribution levels are established pursuant to the sponsorship agreement between the co-sponsors, ATU 113 and the TTC. Contribution level changes, require Bylaw amendments, and therefore must be sanctioned by the Commission and approved by the Membership at the Society's Annual General Meeting. Contributions are shared equally between the active Members of the Society and the TTC.

The assets of the Society, totalling $3.7 billion at year-end 2010 are all managed by external Investment Managers, whose activities are governed by the Society's Statement of Investment Policies and Procedures as well as Guidelines specifically prepared for each manager (Appendix A). Investment Management fees, including custodial fees, are paid out of the assets of the Society. Hiring, monitoring, and if necessary termination of Asset Managers, is the sole responsibility of the Board of Directors acting with the advice of external advisors who are listed in Appendix (B).

The five management appointed Directors of the TTCPFS; in addition to their professional qualifications hold the Chartered Directors designation from the DeGroote School of Business of McMaster University.

Plan Type/Benefit Comparison

The Society operates a Defined Benefit Pension Plan which has some similarities to the OMERS plan.

The benefits under the TTC Plan are based on a four year average base period, and some indexing is provided under the terms of the Plan. Plan Members are eligible to retire at age 60 or after the completion of 29 years of service with little or no penalty for early retirement. OMERS Plan Members' pensions are based on the Members' best five years of earnings up to and including the last five years of the Member's service. This is defined as a final average plan. OMERS pensions in payment are subject to an automatic, guaranteed cost of living increase up to the consumer price index, with a cap of 6% per year. OMERS Members can retire at either age 60 or age 65, depending on the OMERS Plan they are enrolled in (refer to Appendix C).

There are two major differences between the TTCPFS and OMERS.

First, unlike OMERS benefits, the four-year base period in the TTC Plan is not updated automatically. The assets of the Society must be sufficient to meet the cost of a base-period update, as confirmed by the Society's Actuary, before the base-period can be updated. This provision has allowed the Society to defer updates and thus to curtail expenses which might otherwise have required contribution increases. In effect, when funding is not sufficient to support updating the base period, it is not updated. At this time, the four-year base-period for the TTCPFS ends at December 31, 2004, a deferral of six years of base-period updates. The costs, thus deferred have enabled the Society to meet the solvency funding requirements of the Pension Benefits Act.

Secondly, indexing, in the case of the TTCPFS, is also not guaranteed and has, in fact, been withheld for several years in the on-going efforts to meet the requirements of the solvency funding provisions under the Pension Benefits Act. Again, when funding has been insufficient to meet the costs of indexing, pensions have not been indexed. Average indexing provided by OMERS in the years 2006 to 2010 has been 1.4% per annum, the equivalent indexing provided under the TTCPFS has been 0.46%.

The importance of the Society's ability to control these costs is critical and has enabled the Society to remain fully funded on a going concern base throughout the market turbulence of the last three to five years. In 2008, with equity markets collapsing by 40% or more, the TTCPFS asset values declined by 15.5% while OMERS assets were down by 15.3%. Despite the impact of the reduction of their asset base, OMERS benefits in payment were indexed by 2.51% and the base period was automatically updated by one year further

weakening their funding position. During the same period, as plan improvements were not affordable the TTCPFS members/pensioners benefits were neither updated nor indexed.

The absence of these guarantees has also meant that the TTCPFS, relative to the equivalent OMERS NRA 60's Plan has been consistently less expensive than the OMERS Plan.

OPTION 1 - FULL PLAN MERGER

Actuarial Data

Actuarial Data prepared for the Society cannot be released without the permission of the Society's Board of Directors. The issue of Board approval was confirmed by the Society's external legal counsel and, upon receiving that opinion, was reconfirmed by TTC legal counsel. At a recent meeting, the TTCPFS Board of Directors were unable to reach the consensus required to provide this data to OMERS. As a consequence, OMERS are unable to review the relative value of the TTCPFS Benefit structure to that of the equivalent OMERS Plan.

However, the Society's actuaries were requested in late 2010, to provide the Society with a rough estimate of the increase in liabilities which would result were the Plan to be converted to a final average, normal retirement age 60 pension, with guaranteed indexing, such as the OMERS Plan. The estimated increase in liabilities to do this conversion is $1.95 billion, which cost would have to be financed jointly by the Membership of the TTCPFS and the TTC.

In 2009, in co-operation with OMERS, a comparison was made of the amounts which were required by OMERS to buy service for a small group of actual TTC employees, to the amounts which could be transferred to OMERS from the TTCPFS. Based on this analysis, the cash value of benefits available to transfer to OMERS would have represented less than 60% of the amounts required to buy equivalent service with the OMERS Plan.

In summary, it would appear that the assets of the TTCPFS would fall significantly short of the costs to purchase equivalent service in the OMERS NRA 60s Plan and any merger of the plans would entail unacceptably high costs for the TTC and its employees.

Merger Under Bill 236

Bill 236 is expected to simplify plan mergers. It should be noted however, that the regulations under Bill 236 are not yet available. The Bill does however provide, under Section 81 Subsection (6), that the administrators of the two pension plans must have agreed the manner of determining the amount of assets to be transferred between the two plans. The Board of Directors would have to agree to any transfer that provided less pensionable service than the Members have accumulated under the TTCPFS. In fact,

TTCPFS Bylaw 3.09 (iv) (a) (b) (c), (Appendix D), specifically forbids any such reduction in pensionable services.

Contribution Levels

Contributions to the TTC Plan are currently 9.25% of earnings up to $48,300 and 10.85% on earnings in excess of $48,300. There are no plans at this time to increase these contributions especially since the threat of additional contributions being required to fund solvency shortfalls has now been removed through the Society's exemption from future solvency funding.

Contribution rates for OMERS NRA 60 plan is currently 8.9% up to $48,300 and 14.1% on earnings in excess of $48,300. These contributions are expected to rise again effective January 1, 2012 as part of the temporary effort required by OMERS to deal with a going concern shortfall of $4.5 billion as at December 31, 2010.

In summary, in light of the fact that the TTCPFS is an open and active pension plan with substantially different benefit structures, coupled with the potential high cost of preserving the NRA 60 benefit level of TTC employees in any merger as well as the higher current contribution rates of the OMERS NRA 60 plan there would appear to be no obvious savings to the Membership or to the TTC inherent in any merger. In fact, such a merger would be expected to add substantial additional costs for the parties involved.

OPTION 2 - INVESTMENT MANAGEMENT SERVICES THROUGH OMERS INVESTMENT MANAGEMENT (OIM)

The selection, monitoring and retention or termination of Investment Managers is the sole responsibility of the Board of Directors of the TTCPFS. In 2007, the Board began the process of restructuring the Society's Investment Managements and the scope of the Society's asset types, with a view to improving returns. This has involved the addition of more complex investments such as specialist fixed income managers, infrastructure investments, the use of hedge funds and active currency hedging (refer to Appendix A). The result has been a steady improvement in returns. Average returns for TTCPFS and OMERS over three and five year periods are noted below:

Period	***TTC***	***OMERS***
3 years	**3.0%**	**2.4%**
5 years	**4.0%**	**5.8%**

Investment management for the TTCPFS is all outsourced. The Society uses a mixture of passive management in markets in which it is considered impossible, in the long term, to outperform and active management in markets in which there is a reasonable opportunity to outperform. Investment expenses are paid for by the TTCPFS and were 0.23% in 2010. Investment expenses incurred by OMERS in 2010 were 0.63%. Were the Board of Directors to retain OIM to manage the entire portfolio of the TTCPFS, investment management costs, before one-time start up costs and profit for OIM, would increase by almost $15 million per annum or 74%.

That being said, OIM have developed large infrastructure investment and private equity vehicles which could, based on possible economies of scale, offer advantages to the Society. For this reason, it may be appropriate for the Society and OIM explore the options available through "S contract" arrangements offered by OIM in the areas of infrastructure, real estate and private equity.

OPTION 3 – PENSION PAYROLL AND MEMBER SERVICES BY OMERS

Under this option, the TTC would transfer responsibility for the day to day payroll administration as well as Member services such as enquiries, benefit calculations and member communications to OMERS.

In order to provide these services, OMERS would be required to create a subsidiary for third party administration purposes. Currently, OMERS does not have a legal structure in place to do this and would require internal approvals to proceed.

The TTC would continue to be responsible for providing support to the Society in the areas of accounting, corporate secretarial and management as well as data management. Staff would continue to deal with the preparation of audited financial statements, annual actuarial reports, reports to the TTC and all required filings with Provincial and Federal authorities.

The TTC expense for all of services provided to the TTCPFS was $1.2 million for 2010. Of this amount, the cost of the services which would be assumed by OMERS was $695,000, or $23 per Member/pensioner.

Discussion with OMERS of this proposal has not occurred, although similar services to the City were offered the cost of approximately $65 per Member/Pensioner before one-time start-up costs.

If these costs are applicable to the third-party services available to the TTC through OMERS, this would represent a total increased cost of $797,200 per annum, or $42 per Member/Pensioner. On this basis, this option is not recommended for further consideration.

APPENDIX (A) - Investment Management Services through (OIM)

- TTCPFS returns comparable to OMERS in last three years
- Assets 100% externally managed at a cost of approx 23bps to fair value of net assets
- Level of sophistication of the Plan's investments has evolved significantly over past several years – Funds of hedge funds, Infrastructure, active currency, tactical asset overlay. Increased the number of managers and further diversified investments without adding to costs of administration.
- Strategically reduced equity exposure in 2008 through asset rebalancing overlay program in order to dampen the effects of the severe market downturn

Asset Mix/External Managers as at December 31, 2010
(Market Value in $ thousands)

PORTFOLIO MANAGER	MANDATE	CASH & EQUIVALENT	CDN. EQUITY	* U.S. EQUITY	* INT'L. EQUITY	FIXED INCOME	REAL ESTATE	INFRA - STRUCTURE	TOTAL	
									$	%
Phillips, Hager & North	Canadian equities and bonds - active	10,475	224,162			416,592			$ 651,229	17.8%
BlackRock	Replicate bond indices - passive					627,004			$ 627,004	17.0%
Letko Brosseau	Canadian equities - active (Note 1)	16,386	282,559						$ 298,945	8.1%
Jarislowsky	Canadian equities - active	5,849	293,063						$ 298,912	8.1%
State Street	US equities - passive	726		297,460					$ 298,186	8.1%
Brandes	Non-north American equities - active				202,416				$ 202,416	5.5%
Wellington	US equities - active	1,146	152	182,289	2,179				$ 185,766	5.0%
In-House	Real estate and infrastructure	1,617					161,107	11,500	$ 174,224	4.7%
Crestline	Funds of hedge funds - portable alpha	39,722				126,160			$ 165,882	4.5%
Thornburg	Non-north American equities - active	1,122	2,661	8,163	147,271				$ 159,217	4.3%
Invesco	Non-north American equities - active	7,878			146,324				$ 154,202	4.2%
Canso	Credit strategy - active	1,233				141,032			$ 142,265	3.9%
TDAM	Credit strategy - active	1,572	841			139,253			$ 141,666	3.8%
Mesirow	Currency Hedge	7,381							$ 7,381	0.2%
State Street	Asset mix rebalancing overlay strategy	170,578				5,503			$ 176,081	4.8%
		(309,614)	(17,336)	116,412	48,636	161,902				
TOTALS		$ (43,929)	$ 786,102	$ 604,324	$ 546,826	$ 1,617,446	$ 161,107	$ 11,500	$ 3,683,376	
TOTALS (%)		-1.2%	21.3%	16.4%	14.8%	43.9%	4.4%	0.3%		100.0%

* All foreign investments are valued in Canadian dollars.

Note 1 - Manager mandate changed from Canadian balanced to equities in November 2010
Note 2 - Manager hired in 2010, one year performance is not available

APPENDIX (B) - Professional Advisors

Northern Trust is the Society's custodian.

Morningstar Canada provides performance measurement of the Fund's investment managers.

Actuarial services to the Society are provided by Mercer (Canada) Limited.

Mr. James Knowles, President, James A. Knowles Inc. is the Society's Financial Advisor.

PricewaterhouseCoopers, were the Society's external auditors in 2010.

Redcliff Realty Advisors are the real estate consultants.

Osler, Hoskin & Harcourt, is external legal counsel.

Other professional advisors are retained from time to time as required.

APPENDIX (C) - Comparison of Benefit Provisions

OMERS have two major plans, a normal retirement age 60 plan (NRA60) and a normal retirement age 65 plan.

Normal retirement at the TTC is age 60. For comparison purposes, we have compared the OMERS NRA 60 plan to the TTCPFS.

	OMERS	TTCPFS
2011 Contribution rates NRA 60 plan	8.9 up to YMPE 14.1% above YMPE	9.25% up to YMPE 10.85% above YMPE
Pension benefit formula	Best 5 year average earnings (final average plan) Updates are automatic	Average of the highest consecutive 4 calendar year's Pensionable Earning prior to 2005 (career average plan) Updates are done based on affordability

Cost of living Increases to Pensions in Payment

OMERS increases are contractual, TTCPFS are ad hoc based on affordability

	OMERS	TTCPFS
Year	**Contractual**	**Ad hoc**
2010	1.61%	0%
2009	0.37%	0%
2008	2.51%	0%
2007	1.99%	1.1%
2006	0.70%	1.2%
Ave. for 5 yrs	**1.4%**	**0.46%**

The importance of the TTCPS's ability to control costs is critical and has enabled the Society to remain fully funded on a going concern basis throughout the market turbulence of the last three to five years. OMERS has going concern deficit $4.5 billion @ Dec. 31, 2010.

The absence of these guarantees has also meant that the TTCPFS, relative to the equivalent OMERS NRA 60's Plan has been consistently less expensive than the OMERS Plan.

APPENDIX (D) - TTCPFS BYLAW 3.09 (iv)

(iv) No Bylaw or amendment to a Bylaw made in connection with, or at any time after a merger of the Society with any other pension plan shall bring about:

(a) any adverse change in the rights and entitlements of Members who as of the effective date of the merger are Associate Members or Inactive Members; or

(b) any adverse change in the benefit provisions of the Bylaws as they apply to Members who are Regular Members as of the effective date of the merger and their Credited Service prior to the effective date of the merger;

and in particular, without limiting the generality of the foregoing, each benefit provision of the Bylaws as in effect immediately prior to any amendment made in connection with a merger of the Society with another pension plan, including the definition of Normal Retirement Date, shall continue to apply to Credited Service prior to the effective date of the merger as a minimum that cannot be altered except for the advantage of Members, and for that purpose;

(c) all provisions of the Bylaws that provide for an entitlement based on length of Continuous Service, including early retirement rights, shall be applied so that the Regular Member continues to advance toward such entitlements so long as he or she is employed by an employer who participates in the merged plan; and

(d) “Bylaw” includes the terms of the merged plan.