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June 17, 2013

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Ms. Karen Stintz
Chair – Toronto Transit Commission
Toronto City Hall
100 Queen Street West
Toronto, ON M5H 2N2

Dear Ms. Stintz:

Subject: Response to correspondence dated May 24, 2013 from OMERS

The TTC Pension Fund Society Board (the "Board") has received a copy of correspondence addressed to Ms. Karen Stintz as Chair of the TTC Board from Mr. Ian MacEachern of OMERS, dated May 24, 2013 (the "Letter"). The Letter expresses concerns about the PFS Board's draft newsletter under the heading "OMERS Update". The PFS Board wishes to respond to each concern.

The Letter's Opening Paragraphs

The statement in the Letter that the draft newsletter was before the TTC Board for approval is incorrect. The draft newsletter is presented to the TTC Board for information purposes and is not subject to approval by the TTC Board. Only the Bylaw amendments that are included in the newsletter are subject to approval by the TTC Board.

The Letter asserts that the draft newsletter contains material errors. The Board disagrees that the draft newsletter contains errors, as explained below. Moreover, any inaccuracy or other issue that exists in a draft document would of course be addressed in the course of finalizing the document.

The Letter implies that the Board would mislead Pension Fund Society ("PFS") members. The Board strenuously objects to this aspect of the Letter. The Board is the only body with the formal responsibility, as plan administrator, to act prudently and in the best interests of the PFS membership. The Board has a duty to consider the proposed merger with OMERS in that context and has done so. The PFS membership has the right to be informed of the Board's conclusions and the newsletter provides the membership with information about the Board's position along with some of the reasons why it does not consider a merger with OMERS to be in the best interests of PFS members.

PRESENTED TO THE COMMISSION JUN 24 2013

RE-SUBMITTED JUL 24 2013

The Letter states that it is important that the information provided to PFS members be consistent with the facts in the public record, in particular the reports presented to Toronto City Council. The Board agrees that the PFS membership should be provided with facts. The newsletter provides a link to the March 22, 2013 report of the City Treasurer to the Government Management Committee (the "Staff Report") which in turn refers to the OMERS report that was presented in Fall 2012 (the "OMERS Second Report"), because they are entitled to see what is in those reports. However, the Board does not agree that it must accept either report without scrutiny. Furthermore, it would be highly irregular for the Board to defer to OMERS in communicating to PFS members about the merger proposal. Finally, with respect to the public record, the Board suggests that OMERS should have regard to Staff Report which contains a revised analysis of the merger proposals based on the confidential report prepared by Buck Consultants. The confidential report was prepared with the benefit of updated input from OMERS, the TTC and the PFS (see page 7 of the Staff Report).

Under the heading: "Financial Benefits to TTC and PFS Members if PFS Merged with OMERS"
The section of the Letter with this heading states that the Board's conclusion that a merger would not result in significant cost savings is inconsistent with the financial benefits identified by OMERS. The newsletter states that the Board believes a merger "would not necessarily result in cost savings to the City" and "would not result in significant cost savings". The Board believes that these statements are correct.

The Letter highlights two potential financial benefits that were estimated in the OMERS Second Report:

- Legacy Solvency Deficit – that a merger could eliminate any need to fund the PFS's current legacy solvency deficit.

  The Board has concluded that under current laws, a merger would not eliminate the need to make contributions to the PFS in relation to its legacy solvency deficit. As noted in the OMERS Second Report and the Staff Report, the pending asset transfer rules for mergers are expected to prescribe the requirements for funding (among other things). The Staff Report states that it is premature to determine if a merger would benefit the TTC and/or the PFS members (page 11). The analysis in the OMERS Second Report is based on an assumption about the new rules or the ability to influence them (page 12). The Board does not think that it is prudent for it to make the same assumption.

- Administrative Expenses – that a merger would save the TTC $1.5 to $2 million annually.

  The source of this saving identified in the OMERS Second Report is the post-merger elimination of the administrative costs that are currently borne by the TTC alone, not by the PFS (page 14). The Staff Report notes that the basis for this savings is a shift to 50-50 sharing of all cost therefore the cost is not eliminated but is only redistributed. The TTC saving would be in the range of $1 million per year (Staff Report page 15). In the Board's view, although the TTC could save certain expenses, this is not a convincing argument in favour of merger in light of other far more material concerns.

Under the heading: "Other Material Errors"
The section of the Letter with this heading sets out four alleged significant inaccuracies about OMERS in the draft newsletter. Each of these is addressed below.

- Risk Management – the Letter says that the phrase "superior risk management model" (the ability of the PFS to alter benefits and contributions to adjust to circumstances) implies that OMERS does not have this option, and that the discussion in the newsletter as it relates to OMERS is false and misleading.

  The Board acknowledges that the draft newsletter could have been read to imply that OMERS does not have the ability to control costs in tough times. This was of course not intended. The reference to OMERS follows a discussion of base year updates and ad hoc indexing and the reference was made only in that context. The point, now expressed more succinctly in the final newsletter, is that the PFS does have a superior risk management model, because it is able to forego base year updates and pensioner indexing until they are affordable. The Board notes that, in contrast, for OMERS and other jointly sponsored pension plans in Ontario, final average earnings and pensioner indexing become part of the accrued benefit that cannot be reduced and are included automatically, each year, whether or not they are affordable.

- Comparability of Benefits and Related Benefits Costs – the Letter objects to the characterization of the OMERS NRA 60 benefit as the "most comparable to that of the PFS". It states that it is incorrect to suggest that OMERS provides comparable benefits for higher cost when in fact the rates are higher because the benefits are better. Finally, it states that the OMERS Second Report shows that OMERS could provide similar value benefit at lower cost given OMERS' size and efficiencies.

  The OMERS NRA 60 benefit is the closest comparator to PFS benefits. Even the OMERS Second Report begins its comparison of benefits by saying PFS benefit provisions are "somewhat similar" to NRA 60 provisions under the OMERS Plan with two key exceptions (pages 2 and 9). To say the OMERS NRA 60 benefit is the "closest" or "somewhat similar" is not to say that they are the same. There are significant differences of which OMERS, the Board and the PFS membership are aware, the most obvious being the noted two key exceptions; the final average earnings and guaranteed indexing of the OMERS benefit which make the OMERS NRA 60 benefit more costly.

  The same paragraph of the draft newsletter also discusses the increasing OMERS contribution rate in light of the deteriorating funded ratio of OMERS, compared to the steady contribution rate of the PFS and a modestly improved funded ratio. The message in the paragraph taken as a whole is that OMERS contribution rates are higher and increasing while PFS contribution rates are steady largely because of the risk management built into the PFS benefit design (where base year updates and pensioner indexing are granted only when affordable).

  With respect to the ability of OMERS to offer a similar value benefit at lower cost, the Board finds that the merger proposals do not demonstrate that this is true. The OMERS Second Report proposes post-merger benefits with final average earnings accrual and guaranteed indexing (at 0.5% per annum) (thus eliminating the unique cost control feature of the PFS plan design), but that also reduce or eliminate bridge benefits, early retirement benefits and enhanced normal form (page 10). Even if there might be similar value in the aggregate, the variance by individual can be considerable. With respect to the cost of these benefits, the OMERS Second Report indicates that post-merger contributions could be lower and less volatile. The Board's understanding is that contributions could also be higher and more volatile in certain economic environments. For example if inflation levels rise materially, post-merger contribution levels are likely to be much higher and much more volatile than under the PFS structure, assuming the proposed benefit design.

- Funded Status – the Letter comments that the newsletter's comparison of the going concern funded status of the two plans does not include the fact that OMERS has no solvency special payments while the PFS is still responsible for legacy solvency payments. It also states that going concern is not the only determinant of plan cost, citing OMERS' size and efficiencies.

  With respect to the size of OMERS and the advantages that this brings, the Board acknowledges that OMERS should be very proud of its abilities. However, the Board's analysis of the advantages as they would pertain to the PFS and its membership indicates that while it may be feasible for the Board to consider OMERS Investment Management for investment of some PFS assets as part of a competitive search process (this is reflected in the Staff Report, pages 8 and 9), full merger is not warranted in light of the many other factors that must be taken into account.

  It seems clear to the Board that a comparison of going concern funded status should not reference solvency payments. Moreover, the PFS membership is well aware that the PFS is still responsible, temporarily, for legacy solvency payments which are winding down.

- Cost Savings of Merger – the Letter asserts that there is disagreement between the cost savings predicted in the OMERS Second Report and the statements in the draft newsletter that there would be "no cost savings" (the actual draft newsletter says "no significant cost savings"). The Letter also states that the draft newsletter is contrary to the conclusions of City Council on reviewing the OMERS Second Report.

  This is the same issue that is discussed above under the heading "Financial Benefits to TTC and PFS Members if PFS Merged with OMERS". With respect to the conclusions of City Council, the Staff Report advises that it is premature to determine if a merger would benefit the TTC and/or the PFS members (page 11). City Council appears to have accepted this conclusion. City Council's May 7, 2013 decision is to delay further assessment until after the regulations on plan mergers are in place.

The Letter's Closing Statement

The Letter states that "OMERS is not aware of any actuarial analysis undertaken by the TTC PFS or of any material costs incurred by the TTC PFS or the TTC in connection with the potential merger analysis". It then asks Chair Stintz to consider the information provided in the Letter before approving Agenda Item 8.

Whether or not OMERS is aware of it, the Board has carefully considered the merger proposals. The Board's responses and its communications to the PFS membership are not given lightly or without appropriate due diligence, as Mr. MacEachern's comments seem to suggest.

We have already commented on the fact that the draft newsletter was not before the TTC Board for approval. The Bylaw amendments that were on the agenda for approval have nothing to do with the merger proposals.

Closing Remarks from the Board

The Board acknowledges that Mr. MacEachern has the right to disagree with the Board's opposition to a merger of the PFS with OMERS (most recently expressed publicly in the Board's April 3, 2013 letter to Councillor Paul Ainslie). This disagreement does not mean that the Board's conclusions and the reasons for those conclusions should be disregarded. In fact the Board is in the very best position to assess the merger proposals on behalf of the PFS.

Sincerely,

B.eKinneae
TTC Pension Fund Societye
Presidente

C.eUrodae
Corporate Secretarye