

April 13, 2018

Delivered via E-mail to cotapsa@toronto.ca

COTAPSA
Mike Major, President
77 Elizabeth Street, 33rd Floor
Toronto, Ontario
M5G 1P4

Dear Mike:

RE: Annual Report and Various Governance and Communications Issues

I am writing in response to your letter to the OMERS Administration Corporation Board of Directors (OAC Board) dated April 5, 2018. As noted in my prior email correspondence with you, I would be pleased to meet with you in person to discuss these issues or any other concerns that you may have about OMERS. It was unfortunate that you were unable to attend our Annual General Meeting on April 9th where many of these matters were discussed. I invite you to go to our website to view the video of our meeting.

While the letter raised several specific points of comment or concern for COTAPSA including how certain expenses are itemized in OMERS financial statements, it seems to focus on three broad areas: (i) governance; (ii) communications and disclosure; and (iii) costs incurred by Management and the Boards and the associated value generated for members. These are important matters on which the OAC Board and Management spend considerable time and energy. In an attempt to respond appropriately to your concerns, we will address each of these in turn.

OMERS Governance

OMERS operates on the premise that effective and transparent governance is fundamental in fulfilling the pension promise, and we are committed to achieving high standards in governance. We acknowledge that the bicameral structure of our Boards is unique, but we have worked hard in cooperation with the Sponsors Corporation (SC) to make this legislated structure work for the benefit of 482,000 Plan members.

Your letter challenges the adequacy of OMERS governance on numerous fronts. Governance has been a large focus for the OAC Board and Management, particularly since the Tony Dean review in 2012 which offered helpful observations on the OMERS governance structure as well as actionable recommendations. We have diligently tracked our progress against these recommendations and are proud that we have been able to implement the recommendations that are within our control. We acknowledge that you have lingering concerns over representation on the SC Board, but also acknowledge the effort made by the SC through regular meetings with the unaffiliated groups to improve communication and invite constructive input.

Over the last five years, we have made numerous governance improvements including strengthening the OAC Board with skills-based appointees, the addition of an Independent Board Chair, and the development, with the SC, of a joint Strategic Plan for OMERS.



In 2017, an updated Competency Framework for the OAC Board and an associated Skills Matrix, mapping individual skill sets against this Framework, were developed to assist the SC in the recruitment of new OAC Directors. This Framework supports the continued development of a high-capacity OAC Board where directors have demonstrable skills and experience in areas that are critical to the business and success of OMERS. The Competency Framework is published on our website. We are proud of the changes we have made in this area which represent best practices in Canada. I focus on this as a number of your comments relate to oversight of matters such as strategy, compensation and transparency, where members must necessarily rely on their Board to bring necessary skills to bear in carrying out its fiduciary obligations.

I would also point out that the Competency Framework specifies that “each Director must be able and willing to devote the time and effort necessary to be an effective Board member”. The implication of your letter is that I am “over-boarded”. My attendance record is set out in the Annual Report, and I have been both able and willing to devote the necessary time to fulfill my obligations as OAC Board Chair.

The Competency Framework and Skills Matrix also assist me in populating the Board Committees with appropriate expertise. The OAC Board currently has six Standing Committees: Appeals; Audit & Actuarial; Governance; Human Resources; Investment; and Technology. The OAC Board is also supported by a new ad hoc Risk Oversight Committee as well as the Joint Council, which includes members of both the OAC and SC Boards and serves as a vehicle in which to surface and address matters of importance to both Boards.

Each Committee has a Board-approved mandate, develops an annual work plan to guide its efforts, and has oversight and approval authority for policies related to its mandate. Of particular relevance to your stated concerns, I would like to call out the roles of the Audit & Actuarial and the Governance Committees.

Audit & Actuarial Committee: Responsibilities include, among other things, oversight for the integrity of the financial reporting process and financial statements; system of internal control and disclosures; external audit of the financial statements; and the organization’s processes for monitoring compliance with policies, laws and regulations and the Code of Conduct and Ethics.

Governance Committee: Responsibilities include, among other things, approving and implementing regular performance assessments of the OAC Board, its Committees and individual Directors; recommending changes to the OAC Board’s processes to address effectiveness issues arising out of the assessments; assessing the competency requirements of the OAC Board and recommending skills and experience needs for the Board and confirming the specific competencies of individual Directors.

For more detailed information regarding our governance model, we would encourage you to refer to our Governance Manual which can be found online at: https://www.omers.com/About-OMERS/OMERS_Governance/Administration_Corporation/Governance-Manual-Policies-Guidelines. I would note that we are one of the few institutions that actually posts its Board-approved policies on its website.

Overall, we are confident that the OAC Board’s governance framework, inclusive of our Committee structure, policies and procedures, is robust and exceeds industry standards for good governance.

Transparency and Disclosure

In our annual reporting and website disclosure, OMERS objective is to provide members with meaningful and relevant information to promote an understanding of our pension plan and its health, as well as an understanding of how we manage the Plan on their behalf. We consider materiality, relevance and utility, as well as cost of our disclosure to members.

Your letter expresses some concerns about the level of disclosure in our reporting and provides some suggestions on how disclosure can be improved. We thank you for your suggestions and will take them into consideration as we continually look to improve reporting. Of course, it is not possible or practical to satisfy every particular request for disclosure; some constituents are focused on certain items that may or may not be material to plan members as a whole. The Board and Management need to make determinations of materiality in presenting information to members that is meaningful, concise and understandable.

In providing disclosure we comply with all applicable laws including the *Pension Benefits Act* and with financial reporting standards including the Chartered Professional Accountants of Canada Section 4600 – Pension Plans, which is the basis for Canadian accounting standards for pension plans. For accounting policies that do not relate to OMERS investment portfolio or pension obligations, we adhere to the requirements of International Financial Reporting Standards.

Although we are not a public company subject to the disclosure requirements of listed companies under Ontario securities laws, we voluntarily adopt many of the public company disclosure practices in an effort to enhance the quality of disclosure to our members. In addition, we perform annual benchmarking and believe that our disclosures are generally consistent with our peers.

In summary, we are confident that our disclosure practices are appropriate; however, we will consider your specific feedback and suggestions as we continue to evolve our reporting and our website interaction with members.

Expense Management & Value Added

Your letter suggests that we lack appropriate policies and processes related to expense management, and that certain expenses are excessive. With respect, we disagree with this assessment.

The OAC Board and Management believe that prudent expense management is imperative; expenses are reviewed annually with the Board and Management as part of our Operating Plan approval process. This process begins with a bottom-up build of expense and investment return estimates by Pension Services, Corporate Functions, and the Investment Businesses. These expense and return estimates are then subject to review and robust challenge by the Senior Executive Team and relevant OAC Board Committees, and are ultimately reviewed and approved by the OAC Board.

Once the expense budget has been set, we have numerous policies in place to guide expense management at OMERS. These policies are posted on our website and include: Board Education & Expense; Director Remuneration; Financial Disclosure; and Sponsors Corporation Support and Reimbursement.

Your letter specifically focuses on OAC Board expenses such as conferences and travel. I can confirm that during my tenure, Board expenses have decreased materially. When I assumed the Chair in October 2013, I conducted a review of Board expenses. They have come down from \$529,138 in 2013 to \$200,406 in 2017. Board consultant expenses (e.g. executive compensation, which is disclosed in the Annual Report) have also decreased materially during that time. In my view, this has occurred hand-in-hand with the development of a high-capacity Board, which has been a key evolution in the maturity of the OMERS governance framework as discussed above. With respect, we do not believe that listing out every conference or travel expense of each director is meaningful and relevant disclosure, and I can confirm that the review of these items is well in hand through our Governance Committee. The Annual Report does include total expenses for each director.

Your letter also expresses concerns around compensation programs for investment employees, costs for professional services, and travel and communication costs for employees. I can assure you that the Board and its Committees spend much time on these matters, whether through its HR, Investment or Audit & Actuarial Committees. With respect to investment employee compensation plans, we do have short-term and long-term incentive programs for our employees, in line with our pay-for-performance HR

Strategy. Our HR Committee also retains the services of Hugessen Consulting, a respected executive compensation consulting firm, to advise it on OMERS compensation plans including providing benchmarking advice, and we are comfortable that our compensation plans are fair and competitive.

Investment expenses are expressed as a Management and Expense Ratio (MER) which is disclosed in the Annual Report and was 55 basis points (bps) in 2017, compared to 61bps in 2016 and on trend towards our long-term target of 50bps. Management is working diligently to bring the expense ratio down including through some innovative third-party capital initiatives which would allow us to leverage the skills we have developed in our infrastructure and real estate platforms to manage third-party capital alongside OMERS capital for a fee, which would benefit OMERS members by reducing their MER.

Of course, management costs and MERs should be viewed not only in their absolute dollar terms but through the lens of value added. For example, over the last four years during the current CEO's tenure, net investment assets have grown by \$30 billion, from \$65 billion to \$95 billion. During that same period, our net investment income has increased from \$3.6 billion to \$9.7 billion, while our investment management expenses have increased from \$266 million to \$409 million. In other words, we have incurred \$143 million of incremental investment expenses to generate \$6.1 billion of incremental net income. We believe this is indicative of positive operating leverage in OMERS model, and the considerable value that Management and the OAC Board have delivered to our members through this period.

Our strategy is to continue to develop a global investment business and we have been completely transparent about that. Global growth will involve increased travel and communications costs, and large multi-jurisdictional transactions for best-in-class assets will incur significant professional and consulting fees. Management is vigilant and prudent in managing these fees, whether alone or with our investment partners on transactions, which often include our large Canadian pension plan peers. In fact, we are typically able to achieve discounts to market rates because of our size and the nature of the transactions in which we are involved.

I hope you are more assured through this exchange of letters as to how we approach governance and disclosure matters at OMERS and the seriousness with which we approach our duties and our commitment to Plan members. In addition, we have included in an Appendix specific answers to certain questions you have raised in your letter that may not have been addressed above.

Yours truly,



George Cooke
Chair, OAC Board

cc: Board of Directors, OMERS Administration Corporation
M. Latimer, CEO, OMERS Administration Corporation
B. Hutcheson, President and Chief Pension Officer, OMERS Administration Corporation
M. Kelly, Executive Vice President and General Counsel, OMERS Administration Corporation
M. Love, Co-Chair, OMERS Sponsors Corporation
F. Ramagnano, Co-Chair, OMERS Sponsors Corporation
P. Harrietha, CEO, OMERS Sponsors Corporation
B. Mills, CEO and Superintendent, Financial Services Commission of Ontario

APPENDIX

Responses to Specific Questions:

- #1) *Request to see individual letters from the Independent Board Chair and the President & CEO.*

You have requested individual letters from the Independent Board Chair and the President & CEO that speak to prior year accomplishments and priorities for the upcoming year. OMERS has a joint strategy that is shared and approved by both Boards and executed by Management. In other words, the Boards and Management are working collaboratively towards a common goal – to deliver on the pension promise. We believe that providing members and stakeholders with a unified view on our progress in the Annual Report is appropriate. It is important to recognize that the Independent Board Chair and the CEO, together with the SC Co-Chairs and the SC CEO, review the Annual Report to ensure it reflects their views before it is submitted to their respective Boards. This approach has been in place since I have been OAC Board Chair.

- #2) *How does 3 years of “strategic planning” for a 10-year joint board strategy, commencing in 2020, benefit members and employers?*

As a pension plan OMERS has obligations that stretch decades into the future, and we believe it is critical that we also think long-term. Many of the decisions a pension plan makes, for example in Plan Design and Plan Funding, take many years to see the results, but they are nevertheless crucial and necessary in order to ensure the Plan remains on solid footing for years to come. The 2030 strategy is intended to focus on those long-term and far-reaching decisions to set OMERS on the right course. Our teams regularly engage with peers, and we can confirm that many of them follow a similar long-term oriented approach.

- #3) *Does the OAC Board have a carried interest program for private assets? If so, what is the dollar value?*

As noted in the letter, we have short-term and long-term incentive programs for our employees. While not pure “carried interest” programs that you would see in the private equity world, we offer a modified version of such programs to our private equity employees that rewards performance based on returns. The dollar value of this program is captured with the MER.

- #4) *Confirm the existence of an actual defined HR/talent strategy.*

We can confirm that we have an HR Strategy, along with an annual operating plan, which are reviewed by the HR Committee of the Board.

- #5) *Concern regarding preferential hiring practices of family and friends.*

We undertake market standard hiring procedures that are role-appropriate and make use of an online job posting system that is open to all interested applicants. Only individuals that are competent for the roles are hired into positions. Our Code of Conduct and Ethics has procedures in place to properly manage any potential conflict situations.

#6) *Pension Administration System*

We commenced the pension administration update project (“LEAP”) with Accenture in May 2015. Consistent with its commitment to achieving leading governance standards, the OAC Board felt that it was important to provide focused oversight of the LEAP Program and established the ad hoc LEAP Program Committee. Subsequently, it became apparent that a broader Board-level oversight commitment was desirable for key technology initiatives at OMERS, and the Technology Committee was formed. The mandate of the Technology Committee includes oversight of the LEAP Program. The Technology Committee is comprised of OAC Board members primarily chosen for their experience relating to pension management systems generally and the implementation of new technology systems.

The LEAP Program is complex, but we are confident that it is in hand. We are sensitive to the value of the pension contributions of our members and take our fiduciary obligations very seriously. You can be assured that we will continue to act in the best interests of our plan members and focus on delivering a high quality system.