Ontario Teachers' Pension Plan's Response to Ontario Ministry of Finance White Paper, October 29, 2010

"Securing Our Retirement Future: Consulting with Ontarians on Canada's Retirement Income System"

The Ontario Teachers' Pension Plan ("OTPP") strongly supports the need to find a retirement security solution for all working Canadians. The need to find the right solution has become even more acute in the aftermath of the 2008 worldwide financial crisis. OTPP is greatly concerned about the number of Canadians who are without any workplace plan, relying solely upon the existing benefits available under the CPP or Quebec Pension Plan ("QPP) and minimum income supplements available to some through the Old Age Security ("OAS") and Guaranteed Income Supplement ("GIS") plans. OTPP applauds the Ministry of Finance's efforts to consult widely on pension reform, and we are pleased to participate in this consultative initiative.

Of the various proposals that have been made to address this urgent need, we believe that the best solution is either an expanded Canadian Pension Plan ("CPP") or the establishment of new multi-employer defined benefit pension plans ("MEPP") which are jointly governed by employer and employee representatives.

Defined Benefit Plans are Better than Defined Contribution Plans

In recent years, there has been a shift in the private sector from defined benefit plans to defined contribution plans. In our view, this movement is sub-optimal. Defined benefit plans are better vehicles for pension saving from both a security and a costing basis, and for both employees and employers. The retirement security afforded by defined benefit plans to members is superior to the security available to members of a defined contribution plan. Further, as we noted in our submission to the Ontario Expert Commission on Pensions[1], the social costs that the private sector's shift to defined contribution plans will impose in the future have not been widely

[1] Report of the Expert Commission on Pensions, "A Fine Balance: Safe Pensions, Affordable Plans, Fair Rules" chaired by Dr. Harry Arthurs, December 2008

acknowledged. Members of such plans will retire without adequate retirement incomes, potentially imposing obligations on future governments for retirement income assistance.

Defined benefits plans are inherently more affordable to sponsors/employers than defined contribution plans. A report by the US National Institute on Retirement Security[2] found that saving in a defined benefit pension plan can deliver the same level of retirement income at almost half the cost of a defined contribution scheme. Specifically, the study found that the ability to pool longevity risk in a defined benefit plan saves approximately 15%; the maintenance of superior balanced portfolio diversification saves another 5%; and the superior investment returns available when large pools of capital are pooled without costly retail administrative fees saves a further 26% (and given the generally higher level of retail administrative fees in Canada than in the United States, the advantages of defined benefit plans may be even greater to Canadians).

The movement in recent years from defined benefit plans to defined contribution plans at both employers' and employees' expense, is in our view the result of short-sighted tax rules and court decisions. These rulings have attacked the superior long-term affordability offered by defined benefit plans by effectively preventing sponsors/employers from saving enough in good times to cover losses in bad times. The compromises of weak managements have also attacked their affordability, who out of expediency, promise unrealistic future benefits in order to dampen current salary demands. Part of the solution to today's retirement security challenge should be a response by our legislators to these short-sighted rules and regulations.

Multi-Employer/Jointly Sponsored Pension Plans

We believe that the governance structure of the multi-employer and jointly sponsored pension plans is the best governance structure. The multi-employer and jointly sponsored governance structure prevalent in many of the existing pension plans has been lauded as superior by many, including Dr. Harry Arthurs in the 2008 Ontario Expert Commission on Pensions[3]. We believe that this model is the best governance structure because it allows all affected parties, employers

[2] "A Better Bang for the Buck, The Economic Efficiencies of Defined Benefit Pension Plans, " National Institute on Retirement Security, August 2008
[3] Report of the Expert Commission on Pensions, "A Fine Balance: Safe Pensions, Affordable Plans, Fair Rules" chaired by Dr. Harry Arthurs, December 2008

and employees, to not only have a "say" in their plan but just as importantly, to be directly accountable for any changes to their plan. Jointly sponsored and multi-employer plans provide for at least 50% of their governing body to represent plan members. In our view, the provision of direct member accountability is the most optimal. These plans also provide greater retirement security because they are sponsored by a number of enterprises and, therefore, are relatively immune to employer failure. Finally, because they represent a relatively homogeneous employee group, such as licensed professions, they can better respond to changes in circumstances in their own unique employee group.

An Enhanced CPP

The proposal to augment the retirement security of all Canadians through the Canadian Pension Plan ("CPP") is a good one. As a well-managed and successful investor of assets, an augmented CPP could be the optimal retirement vehicle for those without workplace pension coverage. And because the CPP benefits members in many of the same ways as does a defined benefit plan, it is a good option in our view.

CPP changes, however, will have a major impact on existing pension plans, many of which are also well-managed and proven investors of assets. Existing pension plans will need to integrate with any CPP changes, whatever form they may take, and the integration issues are substantial. For example, current pension plans offer different benefits than those which are covered under CPP, so any "new" CPP benefits will not mean a dollar for dollar swap. Without a cogent integration of enhanced CPP changes, different members may receive different benefits, particularly if only future service and contributions can be changed. To ensure the fair distribution of benefits, integration may require pension plans to renegotiate existing benefits. Any such renegotiation, however, is complicated by the fact that existing plans do not currently have the flexibility under pension laws to re-open their accrued benefit package. Greater legal flexibility to re-negotiate accrued benefits may be needed to effect an equitable integration.

With increased CPP contributions, the sponsors of many plans, particularly multi-employer and jointly sponsored plans, will likely react by lowering their own plan's contributions to ensure a sustainable aggregative of contributions. For example, at OTPP the joint sponsors currently contribute 22% of teachers' salaries towards pension security which is borne equally by the teachers of Ontario and the government. Therefore, any increase in CPP payments to the federal plan could result in a matching decrease in OTPP contributions. If this does occur, existing plans will be weakened and rendered less flexible in how they can manage their funds. The strengthening of the CPP benefit should not occur at the expense of existing plans, and particularly not at the expense of multi-employer and jointly sponsored plans. Employees and employers in multi-employer and jointly sponsored plans will no longer have a place at the table for that portion of the retirement security transferred away from them to the CPP.

Another critical issue is one of intergenerational fairness. This issue could be triggered by the integration of certain CPP changes, such as the length of the phase-in period. Intergenerational imbalances need to be addressed reviewing all options, including past service. This may increase the demand to change the pension laws so that accrued benefits can be renegotiated. Another critical issue is the need to balance retirement security for all income groups. The Old Age Security and Guaranteed Income Supplement plans which benefit lower income groups will be impacted by certain CPP changes such as increasing the CPP income replacement rate.

Other Possible Solutions

Other suggestions to solve today's national retirement security problem have been proposed which could operate in tandem with an augmented CPP or a newly created multi-employer pension plan. One of these proposals is to raise the retirement age. Another proposal is to transfer all CPP coverage, including any augmented coverage, to the existing multi-employer and jointly sponsored plans which would in essence act as "sub-agents" for the CPP portion of coverage. This is an interesting idea[4] that could be offered on an "opt-in" basis for the particular employee group. CPP coverage would remain universal; rather it would be a question of which plan would manage the members' money and under what governance structure. Any membership opting into this proposal would be able to leverage the engaged and accountable governance model already existing in their own multi-employer or jointly sponsored plan.

[4] The Ontario Secondary Schools Association made a similar proposal in their submissions of November 15, 2010

Call for a National-Provincial Task Force

OTPP believes all these issues for resolving the national retirement problem, including integrating an augmented CPP, can be addressed but they cannot be and should not be decided "overnight". These are complex issues and like all hard problems, the devil will be in the details. We urge the Ministers of Finance that are meeting in Kananaskis in December to carefully consider all the integration issues and other proposals, and not to arrive at a "solution" that only creates new problems. A thoughtful discourse by the policy makers, academic researchers and existing pension plans, outside of the political arena, should take place to find the best solution for all Canadians.

The last time the Ministers of Finance met on retirement security in June 2010, certain pension plans called for a Federal-Provincial Task Force[5] to be struck. It was proposed that the Task Force be mandated by the Ministers and use the pre-existing work of the three pension reform commissions undertaken in British Columbia and Alberta, in Nova Scotia and Ontario[6]. The Task Force would take the time necessary to review all the numerous integration, policy and operational issues of an enhanced CPP and examine other possibilities in the effort to resolve the national retirement problem.

Before the Ministers' meeting in Kananaskis in December, we again urge the Ministers to strike an impartial Federal-Provincial Task Force with a mandate to identify the best possible solution to Canada's pension coverage and costing challenges. We note that the recommendations of such a task force played an important role in the successful CPP/QPP reforms of the 1990s. We believe it is time to strike a new one to address today's complex retirement challenges.

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[5] Letter dated May 19, 2010 to Federal and Provincial Ministers of Finance from Alberta Investment Management Corporate, Alberta Local Authorities Pension Plan, Alberta Teachers' Retirement Fund Board, British Columbia Investment Management Corporate, Healthcare of Ontario Pension Plan, IWA-Forest Industry Pension Plan, Ontario Municipal Employees' Retirement System, Ontario Teachers' Pension Plan and the University of Toronto Asset Management

[6] Alberta/British Columbia Joint Expert Panel on Pension Standards, "Getting our Acts Together: Pension Reform in Alberta and British Columbia" 2008; Nova Scotia Pension Review Panel, "Promises to Keep" 2009; Report of the Expert Commission on Pensions, "A Fine Balance: Safe Pensions, Affordable Plans, Fair Rules" chaired by Dr. Harry Arthurs, December 2008