Remarks by

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To

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Thank you, _____________, and good afternoon, everyone.

As I started to prepare my remarks for today, I looked again at the event theme … "**Time for Action**" the materials said….. And I have to tell you: I cannot imagine a more appropriate theme for this pension conference. What immediately came to mind was the age-old quote: "If not now, WHEN?" Because as all of us in this room know, the clock is ticking on pension sustainability. As an aside, what makes that quote all the more meaningful is that its author, scholar Rabbi Hillel – lived to the ripe old age of 120 – so he seems like a most appropriate person to quote on sustainability issues… [even if he *did* die in 10 AD.]

That said, the good news about pension fund sustainability is that a lot of very smart pension experts in this country are working together, and on their own, and are doing something about it. And people are certainly talking about it. You know when we started saying seven or eight years ago that elections would soon be fought on the pension issue, people looked at us like we were crazy… But you just have to look at the news of the past week to know that this is an issue that is recognized as critical to Canadian society…. Let's look at some Canadian facts and their implications:

- We <u>ARE</u> evolving the <u>defined benefit</u> pension model.

- We ARE building a pension investment funding industry that is second to none in the world. Our collective global investment acumen shows that we have the ability to accomplish the extraordinary. That's why The Economist has dubbed us the "Maple Revolutionaries."
- We DO have a large population of pensioners who are essential contributors to our economy, thanks to their retirement benefits.

  But
- We still need to evolve Canada's regulatory landscape to ensure the best retirement financing security possible.

I’ll start with the implications of evolving the defined benefit model to what some call the target benefit model.

I can speak firsthand about the importance … and practicality … of this evolution, because my organization is living it. Why? Because we have to. The fact is, our members have some of the longest lifespans in the country. But the best part is, the Ontario Teachers’ Pension Plan is living proof that this evolution can and does work.

Consider this: We all know that women tend to live longer than men do. Well, our membership is 75% female. And on top of that, female teachers typically live five years longer than the average Canadian woman. That means they are expected to reach age 90.5. And the guys are catching up: our male members are expected to reach age 88.

But teachers, like students, have their over achievers among their ranks. Our oldest member turned 111 last month. That puts her, at more than 110 years of age, in what I recently heard referred to as the "Super Centenarian" cohort. As of year-end there were 125 other centenarians on our payroll. Six of our pensions have now been in pay for more than 50 years, including one retirement pension that went into pay in 1960, when according to the Conference Board of Canada, life expectancy was 71 … And, we now have one survivor pension that has been in pay for 63 years … or since before I was born!

On average, our members contribute to the plan for 26 years and are retired for 31 years … and as I just noted, a survivor may continue to receive a pension for an additional period.

That equation has shifted over the years. In 1990, for example, members contributed for 29 years and were retired for 25 years. So while longevity has been on the increase in general, our members are at the head of that class. And our plan, like others, was not designed to provide for more pay-out years than contributing years. The math is pretty simple: the longer a pension is in pay, the more it costs.

Lower interest rates only compound this reality, and “low for long” is expected to remain the central bank mantra for some time to come.   Let me illustrate the low rate impact with another Teachers’ example.

Our average retirement age is 59. To fund the typical $48,000 pension, at a real interest rate of 5% we would need assets totaling $705,000. At a 1% real interest rate, however, we would need $1.2 million in assets. That's a half-a-million-dollar swing... or put another way, the equivalent of paying more than ten $48,000 pensions for a year.

This is amplified at Teachers' by the decreasing ratio of active to working members. Over achievers again, we were among the first to hit the maturity curve head-on … that is because so many of our members were hired to teach the baby boomer bulge. We're now down to a 1.4-to-1 active-to-retired teachers ratio, from 4-to-1 in 1990. And that trend is expected to continue. The impact is a real one. Why? Because, in the event of a major market event:

- the only tools available for eliminating shortfalls are contribution rates and benefits
- only future benefits can be changed,
- And that means the burden therefore falls on active members to make up the difference

As a result, our risk tolerance is lower than that of plans with higher ratios. In other words, just when we need the extra returns that higher risk assets can offer, we cannot afford the risk they represent. That’s why our asset mix policy calls for only 45% equities, for example.

In spite of such strong headwinds, however, this year our sponsors -- the Ontario government and the Ontario Teachers' Federation -- together with management, are celebrating our first projected surplus in a decade. We can do this for three main reasons:

- our sponsors' continuing focus on pension sustainability,
- our teams' superior investment returns and funding advice,
- and a modest late-year increase in interest rates.

Let's look at our sponsors' focus on sustainability.

A sustainability task force representing sponsors and plan management is chaired by Professor Harry Arthurs, and is tackling this issue. Each group's actuaries also are involved in these consultations. The actuaries' recent report to the task force wisely opens with an agreed-upon definition of "sustainability".

> "Sustainability," they state, "is the ability to meet the needs of the present, without compromising the ability of future generations to meet their own needs."

I like this definition because it places the need for pension sustainability squarely within the same framework as other matters in our lives so critical to our future...

It was with our demographic reality and the emergence of fund deficits in mind, that our sponsors began modifying our plan's provisions several years ago. This began with the resolution of the 2005 shortfall. In addition to increasing contribution rates from 8% to their current levels of about 12% each for members and employers, they also started introducing flexibility to members' benefits.

And this, in my view, is where the most laudable changes occurred: They made the level of inflation protection available contingent on the financial health of the plan.

They didn’t make sweeping, inflexible change. Instead, they thoughtfully implemented an approach to inflation protection that can be likened to a lever that can be pulled forward or pushed back, depending on our funding level at valuation time. Plan is in shortfall? Reduce inflation protection to the level the plan can afford. Plan is in surplus? Increase inflation protection to the level the surplus permits. Because they acted sooner than later, they were able to take a moderate approach. It is one of the main reasons that we were able to report a $5 billion surplus, based on current plan provisions, as of January 1, 2014. It is an elegant solution that I sincerely hope others will adopt.

This solution was possible at Teachers' for a number of over-riding reasons, the two most important of these being:

- the focus on sustainability that I just described,
- and
- our plan governance model, which allows us to deliver the investment results we've come to be known for.

Teachers' operates like a business. We are independent of our sponsors, with board members who are professional experts. Their backgrounds are in, for example, asset management, actuarial science, chartered accountancy. They delegate all operating authority to the CEO, and I in turn delegate to the executive team and staff. Teachers' is jointly sponsored – and as such, the funding risk is shared equally between our sponsors.

As I said earlier, our members contribute a significant percentage of their salary to their pension. And that is as it should be. It is our belief at Teachers' that pension plans that do not share the funding risk between employees and employers are not sustainable.

I also must add that our members contribute because they must. Participation is mandatory. This relieves them of any temptation to delay contributing until it is too late, or to forego a year's contributions in favour of, for example, a big screen TV or an extra vacation. It is forced savings. And it works. Because they are forced to save, we have the guaranteed funds available to invest. This in turn builds the pensions that they can live on and spend in their communities.

That brings me to the role that pension fund management and defined pension benefits play in Canada’s economy. Just a few weeks ago at our Annual Meeting I told members that one of my biggest points of pride in working at Teachers’ is being part of an industry that is such a strong pillar of Canada’s financial services sector.

Just think of it: the pension fund industry as a major investment force did not even <u>exist</u> just 25 years ago. There were no Teachers’, CPP or OMERS investment funds. Today, however, Canada’s top 10 investment funds alone collectively manage nearly <u>one trillion</u> dollars. Yes, that’s <u>trillion</u>, with a ‘T’. That includes more than $400 billion in various asset classes across Canada.

Together we employ 5,000 men and women directly, and another 5,000 through our real estate subsidiaries. Active management is becoming more prevalent and that expertise is growing. At Teachers', for example, our employees now manage about 80% of our portfolio in-house. There is no doubt about it: Our industry is adding wealth to the economy. Through these plans, Canadians are investing in growing economies globally, adding wealth to their economies, which in turn further enhances Canadian wealth.

And Toronto itself has developed into a world centre of excellence for retirement financing – where talent, experience and motivation intersect. It is home to some of the country's – and indeed the world's - largest and most sophisticated and innovative pension funds, and to Rotman's globally recognized International Centre for Pension Management . I am proud to say that some of our country's best mathematicians, administrators and investment professionals are working in Canada's pension industry today.

Canada's defined benefit pensioners themselves play an important economic role. Plan members pour about $60 billion into the economy annually, for everything from appliances to automobiles, dry cleaning to charitable donations. In fact, pensions comprise a significant percentage of the country's income, especially in smaller communities. In Ontario, for example, defined benefit pensions account for 12% of smaller town income.

Defined benefit pensioners are also a significant source of government revenues, paying a total of about $15 billion in municipal, provincial and federal taxes annually - money sorely needed to connect our communities, deliver healthcare, and educate our children.

These pensioners also are noteworthy for what they don’t cost. Canadian retirees with defined benefit pensions are far less likely than other retirees to collect the government's Guaranteed Income Supplement. Only an estimated 10-15% of DB beneficiaries collect the Guaranteed Income Supplement versus an estimated 45-50% of other retirees... This saves the federal government about $2-3 billion annually in Guaranteed Income Supplement payouts – paid out of current accounts, I must add - freeing up funds for other social spending priorities.

Let me also make the point that in Teachers’ case, 23 cents of every pension dollar paid out comes from members and matched contributions, while 77 cents of that dollar comes from investment returns earned by our team. 77 cents for 23 cents? I’ll make that trade all day, every day!

By almost any measure, our defined benefit pensions are the most cost effective retirement savings system in the country. As an expert committee on the Future of the Quebec Retirement System said last year: “Defined benefit plans provide the type of financial security that should be emphasized…No other supplemental pension plans or personal savings vehicles can provide members with the same level of financial security.”

Here, in a nutshell, is why:

- Defined Benefit plans pool longevity risk.
- Defined Benefit plans pool asset mix risk.
- Major DB funds can invest in illiquid investments that individuals can’t afford, for example real estate and infrastructure...

- By pooling their savings in a DB Plan, the participants can afford their own in-house professional investment advisors – something that the average worker with a DC Plan or RRSP cannot afford.
- DC Plans and RRSPs are usually invested in retail products that carry a large range of administrative fees – it is not uncommon to see retail products with fees as high as 2% per annum. Contrast that with the cost at Teachers' of only 25 basis points. The extra 1.75% over a working lifetime is a huge cost - amounting to just under 40% of the total funds you could have for your retirement.

The Ontario Teachers' Pension Plan is positioned well from a funding and regulatory perspective. It has not been without effort, but we are in a much more stable place now. This is partly because we are a public sector plan, partly because of our governance structure, and partly because all of our members are in Ontario.

Many other plans are not as fortunate. This is especially true of private sector plans. In fact, private sector DB plans are becoming increasingly rare because employers have been so bogged down by arcane and complex regulatory frameworks and rules that are not harmonized from province to province.

Funding rules, solvency rules, wind-up rules, accounting and tax rules. Simply put, the current framework is cumbersome and expensive and it is driving employers away from the model. We need to harmonize and simplify the rules for private and public sector plans and from region to region across the country.

As I illustrated with the benefits that the evolved DB model brings to the Canadian economy, driving more organizations away from the DB model will be costly to our economy in the long run. It threatens the financial retirement security of generations of future seniors. This in turn handicaps our economy, which needs the spending and tax revenues of financially independent seniors.

I am not naïve enough to think that DB, evolved or otherwise, is the only way forward to ensure financial security in retirement. What I am saying is that we must look out for the increasing numbers of Canadians without adequate workplace pensions. I hear more and more troubling stories of companies that have closed their pension plans to new entrants or eliminated the plans altogether because they have become too costly and complicated to maintain. One global corporation comes to mind here. This company had made a number of acquisitions over time and found itself responsible for eight pension plans in Canada alone … all of which had to be reported on. Think about the plethora of ever-changing accounting rules, for example: It had to produce separate valuations to conform to U.S., Canadian and European accounting standards. And that was just one of the many obstacles they faced – add to that mix,

among other things, Income Tax Act restrictions, onerous legislation, lack of regulatory consistency from province to province, and volatile funding due to solvency rules.

As a result, that corporation, like so many others, gave up. They fully wound up the six smallest plans. The remaining two were converted to vanilla-flavoured defined contribution plans, with all of the investment and longevity risk shifted onto the employees' shoulders. Certainly not the best solution for the employees, as I'm sure you'll agree.

In closing then, let me say: Now that we are seeing progress on evolving pension plan models to recognize the reality of today's demographics, it's time to take a long and hard look at also evolving the regulatory framework. As a major player in the financial services sector, it is incumbent upon us, the Canadian pension fund industry, to do what we can to convince the regulators of the urgency of this situation.

It is time for harmonization and simplification. It can be done and it should be done. Will it be easy? No, it won't. Is it necessary? It certainly is. Why? Because there are too many Canadians destined to a retirement without adequate pension coverage otherwise.

If the regulators fail to evolve the rules and make it easier for employers to provide reliable, effective pensions, they threaten with extinction the financial retirement security of many Canadians. They will stifle the economic stimulus that pensions can provide and they will place a huge retirement financing burden on all tax payers.

And in my view, as they say, this is a bird that just won't fly.

Thank you.

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