Claude Lamoureux
Retired President and Chief Exective Officer

to the

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Thank you for that kind introduction.

Economists and Actuaries have a lot in common.

They both deal with uncertainties.

They both use quantitative methods.

They both can be blamed when their assumptions do not happen as predicted.

One difference between the two is that economists are called to make predictions about the whole economy of a country whereas actuaries make predictions about very specific risk.

This is the first time that I have addressed the Economic Club of Toronto. I'm not sure why it has taken until I retired to speak to you, but I am finding that life is like that!

I trained as an actuary. Strangely, none of my job titles had the word 'actuary' in them. But my actuarial training was very useful and gave me the tools to help my employers achieve a few things. One of those achievements was to administer one of Canada's largest defined benefit pension plans—a plan that provides security to more than 278,000 active and retired teachers in Ontario. To say that I am a supporter of defined benefit pension plans is like saying I like good governance.

In fact, I am still a member of the Canadian Institute of Actuaries and recently I became a Special Advisor to the Institute. Over the past few years, the Canadian Institute of Actuaries has assumed a greater role in advocating in the public interest for legislative and regulatory changes in the areas of auto insurance, pension and Employment Insurance reforms.

Ladies and gentlemen, today I am here to tell you that there is a huge change taking place in Canada's pension system. Specifically, defined benefit pension plans are disappearing. I also want to tell you that solutions have been proposed, including ideas from my professional organization, the Canadian Institute of Actuaries and some of my own.

I plan to share a few ideas with you. Some of them may not necessarily be new, but Canada needs a roadmap to resolving retirement savings issues and I believe these ideas will help.

One of the best pension funds I know of is the Ontario Teachers' Pension Plan. It is a defined benefit plan with benefits fully indexed to the cost of living. Teachers can retire when they reach the rule of 85 — i.e., when age and years of service add up to 85.

What are the benefits? Roughly 60 per cent of the average of the best five years salary. Imagine if all Canadians had such a plan?

To get these benefits, teachers start contributing over 10 per cent of their salaries from the first day of their career up to retirement, and the government matches those savings.

Yes, if you want good benefits, you need to save over 20 per cent of your salary from day one of your career and hope that you have Bob Bertram investing your money for 70 to 80 years…and Bob needs to earn 5 per cent real return.

How easy is earning a 5 per cent real rate of return? It's not easy at all! All the economists in the room will know this to be true!

Dimson, Marsh and Staunton analyzed this issue in their book, "Triumph of the Optimists: 101 Years of Global Investment Returns." They looked at historical rates of return from 1900 to 2001, from 16 countries. Based on an asset mix of 60 per cent equities and 40 per cent fixed return investments, only one country consistently succeeded in achieving a 5 percent … Sweden. Canada's result was 4.5 per cent, one of only six countries with returns of between 4 and 5 per cent.

How many Canadians have realized that the cost of a pension has increased dramatically over the last 15 years. The increase in the case of the Teachers' Plan is in the order of 70%...and 1/5 of this 70% is due to improvement in mortality.

Contrast the Teachers' Plan with the following situation:

One-third of Canadians have no retirement savings at all. A good many of the other two-thirds are not saving enough to fund an independent retirement.

At the same time, the defined benefit pension plan, an effective retirement income security vehicle, is in decline. We should all be deeply concerned that eventually Canadians will no longer have access to defined benefit pension plans. This could be an avoidable loss. In some ways, it is happening now, as many firms' existing defined benefit plans do not allow new employees to join.

Ask yourselves what kind of pension plan you want for your children.

Between 1992 and 2003, the percentage of Canadian workers with defined benefit plan coverage in Canada dropped from 44 per cent to 34 per cent, which is a drop of about one-quarter. Over the same timeframe, the number of defined benefit plans declined by 14 per cent. In 1992, more than 90 per cent of Canada's public sector workforce and 29 per cent of private sector workers were covered by a Defined Benefit plan. Twelve years later [2004], those numbers had dropped to 80% and 20% respectively.

I think most of us would be hard pressed to remember the last time a single-employer defined benefit plan started up. If the trend continues, the only Canadians covered by a defined benefit plan will be politicians and government employees. Imagine how taxpayers will feel about supporting these plans through their taxes, when their own workplace offers either a less effective program or none at all!

Some have said it's time for defined benefit plans to make a well-deserved exit. I disagree. Let me state this clearly: I believe the defined benefit pension is one of the best ways to save for retirement. And here's why.

1. Defined benefit plans deliver greater predictability for plan members. Plan members have a clear idea of what they will receive in retirement, making future planning easier and reducing uncertainty. A strong defined benefit system also means less uncertainty for governments.

2. Defined benefit plans offer more security and less risk to plan members. Individuals in defined benefit plans face lower risks related to the current level of low interest rates, improving longevity and volatility of stock market returns.

3. Defined benefit plans deliver better investment returns. With larger pools of money to invest and longer investment time horizons, plan sponsors can use a more aggressive, diversified and informed investment strategy with much lower management fees. Over the long run, the higher yields and lower administration costs result in greater value for dollars invested in defined benefit plans compared with defined contribution plans.

4. Defined benefit plans yield greater economic benefits to society and the economy. Former Bank of Canada Governor David Dodge has spoken out in support of Defined Benefit pension plans for a variety of reasons. In a speech to the Canadian Club last December, Mr. Dodge said, "*Pension funds can generate important gains in terms of economic efficiency. They help to achieve a more efficient allocation of savings; they are invested by asset managers who have the incentive and the ability to invest across varied asset classes; and, with their very long investment horizons, pension funds can be used to finance long-term investment projects at competitive rates of return*."

   David also told l'Association des MBA du Québec in late 2005 about the decline in DB plan coverage. He said, *"…one important part of our pension system—defined-benefit plans—has been in relative decline. This relative decline represents a transfer of return risk and longevity risk to individuals, who are less able to bear or manage them. This transfer has a negative impact on overall economic efficiency and could ultimately represent a significant threat to the ability of pension funds to finance the long-term investments that will maximize our economy's future potential growth."*

Defined benefit plans are not perfect, and can be improved, but despite their many advantages, this decline has continued.

As you know, Canada's pension system has several pillars. The first pillar is government income support, such as Old Age Security and the Guaranteed Income Supplement. Next is the Canada/Quebec Pension Plans, followed by workplace pension plans. Finally, there are personal savings through RRSP contributions, home ownership and other individual savings methods.

In the 1990s, Old Age Security and the Guaranteed Income Supplement, which accounted for 30 per cent of a retiree's income, dropped to 27 percent a reduction of 10 per cent. The proportion of a retiree's income from the Canada and Quebec pension plans rose from about 16 per cent to about 20 per cent. The proportion of retirement income from workplace pension plans and Registered Retirement Savings Plans rose from 18 per cent to almost 30 per cent, with the balance coming from other personal investments.

In terms of the pools of capital, at the end of 2003 the sum of these savings totaled more than $1.3 trillion one of the largest pools of investment capital in the country.

Are workplace pensions important? Yes! They represent over 50% of this $1.3 trillion. And not only to support retired Canadians financially, but as a positive influence on the country's financial markets and economy.

But again, to address why the decline of Canada's pension system is occurring, let me refer you to the Canadian Institute of Actuaries' Pension Prescription, released last June.

The Institute's Pension Prescription report noted that Canada's patchwork of regulations, legal decisions and tax rules have created problems which have been compounded over the past several years by:

- Uncertainty regarding contribution holidays and plan surplus ownership
- Low interest rates: real rates have gone from 4.5 per cent in 1992 to 1.56 per cent yesterday
- Increasing longevity of the population

- Volatile market yields: [Volatility is not much higher today than it was 20 years ago, and in fact volatility is a strong reason why one should be in a defined benefit plan]

- And rising pension costs.

I would like to comment on a few of these issues.

First, on the patchwork of regulations across the country: At a recent meeting in Ottawa with an MP who sits on the Finance Committee, one actuary mentioned a brochure that a client was going to distribute to employees across the country on their defined benefit pension plan. The brochure must have been the size of a phone book, as the definition of the word ‘spouse’ ran to eight pages! Why? The only reason is the differing regulations between provinces.

In my view, there must be a way of harmonizing pension regulations across the country and this must become a priority with governments.

Secondly, on surplus ownership: As you may know, plan sponsors are responsible for plan deficits in poor economic times, but they can’t access the surpluses generated in good economic times.

This is probably the number one issue impacting the future of defined benefit plans in Canada. Some plans have joint ownership of surpluses between the plan sponsor and plan members. In most plans, as a result of court decisions, plan members own the surplus. Plan sponsors would be more likely to fund a defined benefit plan more conservatively if they knew they could get back surpluses that might arise from their contributions. This could help the maintenance of existing defined benefit plans and the creation of new defined benefit plans.

Provincial governments have known about this problem for years, but have been reluctant to change the law to clarify this issue. But if they lack the appetite for such a change, then perhaps there are some work-arounds that will help in the short term.

For example, Canada's actuaries propose the introduction of legislation to enable the creation of Pension Security Trusts, or side funds. These trusts would be fully funded and owned by plan sponsors. Contributions arising from going concern actuarial valuations would go into the regular pension fund, while additional contributions, including those required for solvency deficiencies, could be made to the Pension Security Trust. If a subsequent solvency valuation determined that the funds were not needed to fulfill the pension promises, the surplus funds could be released back to the plan sponsor. Furthermore, actuaries propose that the amounts contributed to the Security Trust be tax deductible, while amounts returning from the trust to the employer would be taxable.

I also support another idea from the Institute's Pension Prescription, which is for governments to introduce legislation requiring each defined benefit plan to establish a Target Solvency Margin related to the risks in the plan's asset mix, the demographics of the plan members and retirees, etc. The margin could be funded by a Pension Security Trust, a Letter of Credit or the assets of the plan. Contribution holidays would not be permitted if the plan's surplus was less than the Target Solvency Margin. For example, if a plan had a Target Solvency Margin of 8%, the plan sponsor would have to continue to make contributions as long as the plan assets were less than 108% of the solvency liabilities.

The Institute has already worked on Target Solvency Margins with the Quebec government. A Task Force of the CIA released a paper last November which the Quebec government has used in putting together its plan. Other governments also need to look at this idea.

Another idea proposed by Canada's Actuaries is to change the federal tax rules to allow defined benefit plans to develop surpluses much greater than the current 10 per cent limits. It is easy to demonstrate that in a mature plan surpluses could reach 30 to 40 per cent of assets…deficits could also be of the same magnitude and could be amortized over a longer period of time.

If a plan sponsor wanted to make contributions over those made necessary as a result of actuarial valuations, this would only improve the security of benefits for plan members. Why would governments stand in the way?

In its federal pre-budget consultation submission last fall, the Institute made all these points, and met with many Finance Committee members and officials from the Finance Department. The Finance Committee recommended to the Minister that "… the federal government amend the Income Tax Act in order to increase, to a proportion to be determined in relation to going concern liabilities, the maximum tax-deductible surplus in respect of defined benefit pension plans before plan sponsor contributions must be suspended."

Unfortunately the recommendation did not find its way into the federal budget. But others are seeing the idea's merits. A few weeks ago, the C.D. Howe Institute called for reform of the provision of the federal Income Tax Act that prevents sponsors from contributing to pension plans when their assets exceed their recorded liabilities by 10 per cent. Their paper demonstrated how the 10-per-cent limit increases the frequency of plan underfunding on an annual basis over 20 years and it recommended either eliminating the limit altogether or raising the limit to 25 per cent.

Barbara Zvan and her team at Teachers' also demonstrated the same thing and convinced the federal government to raise the limit for jointly sponsored plans.

But perhaps the federal Minister was reluctant to make changes while Ontario, British Columbia, Alberta and Nova Scotia are studying pension legislation and regulation. This brings me back to my earlier comments about harmonization.

In May 2005, the federal Department of Finance issued a consultation paper titled, "Strengthening the Legislative and Regulatory Framework for Defined Benefit Pension Plans Registered under the Pension Benefits Standard Act, 1985." Shortly after the deadline for submissions, Parliament was dissolved and there was a change in government. Pension reform was not part of the new government's Five Priorities, however, Quebec did move forward at the end of 2006 by putting a number of principles

in place, and they are working on the supporting regulations which will come into effect in 2010.

With the various provincial reviews underway, I imagine all of us here today would believe that the time is right to put in place some degree of federal/inter-provincial harmonization and reform.

I believe that it's time to put pensions on the national agenda. The demographics of Canada's population alone demand such an effort.

Perhaps a good place to start would have been at last week's meeting of Canada's finance ministers in Montreal. Sorry. Couldn't have happened. Pension regulation falls within the portfolios of only four of the 10 provincial ministers plus Minister Flaherty. To my knowledge, ministers responsible for pensions have never had a meeting to talk specifically about pensions.

But why couldn't they?

To make necessary changes to the Canadian Pension System and reverse the downward spiral of defined benefit plans, Canada needs to hold a national Pension Reform Summit. At such a summit, Ministers responsible for pensions could assemble and focus on the financial future of Canadians, and agree on a roadmap for cross-country reform which would lay out an agenda with some high-level exchanges, some study and legislative deadlines for reform.

Let's take it a step further. All the current provincial reviews will be delivered to their respective ministers this fall. By September, ministers will have some sense of the direction of the reviews, if not the details. Therefore, why not call a national Pension Reform Summit for the end of 2008.

A national Pension Reform Summit will stimulate the positive appetite for much-needed pension reforms among the ranks of government officials, cabinets and caucuses. The CIA would be pleased to help organize this meeting.

In my mind, if such a meeting were to be held, the positive appetite for necessary pension reform would filter into the ranks of government officials, cabinets and caucuses. It could happen and it should happen.

Although I think that defined benefit plans are generally superior to defined contribution plans, I also think that defined contribution plans can, and should, be improved. Here's what Keith Ambachtsheer, Director of the Rotman International Centre for Pension Management and Adjunct Professor of Finance at the Rotman School of Management, wrote on this subject, "the first rule is to have professional management – that is, to make sure that most employees leave the investment process to the professionals or to trustees who will the select professionals." The second point Keith made is that you need a way to have retirees share the risk of survivorship. Even in retirement, the funds should be professionally managed and the investment process must be such that the cost of investing is kept low.

In fact this morning the C.D.Howe Institute released a paper authored by Keith Ambachtsheer..a Canadian and one of the best thinkers in the world on pension issues. The paper suggests how a new DC program could be set up to cover the 3.5 million workers without a pension plan.

In summary, here are four things I hope you will take with you:

1. People who are interested in pension reform should work together;

2. All governments should work together;

3. Employers won't play in a game where they own the deficits, but can't share the surpluses; and

4. Both defined benefit and defined contribution plans need to be made better.

I would like to conclude my remarks today with a reference from Lewis Carroll, who, when he wasn't writing his "Alice in Wonderland" books was also a brilliant mathematician who tended to take an actuarial view of the world.

To paraphrase an exchange between Alice and the Cheshire cat in “Alice's Adventures in Wonderland,” “If you don’t care where you are going, it doesn’t matter which way you go.”

I think Canadians do care where we want — and need — to go.

We need to choose the road leading to pension reforms and greater uniformity in regulations.

A national Pension Reform Summit is the first step along this road, one leading to a healthier retirement savings system and a brighter financial future for all Canadians.

END OF REMARKS