Response of the

Ontario Teachers' Federation/ Fédération des enseignantes et des enseignants de l'Ontario

to the

Ontario Expert Commission on Pensions

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OTF/FEO

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OTF and the Ontario Teachers' Pension Plan – Some Background

The Ontario Teachers' Federation (OTF) was established by the Teaching Profession Act of 1944 as the professional organization for teachers in the province. All teachers (as defined in the Teaching Profession Act) are required by law to belong to the Federation as a condition of teaching in the publicly funded schools of Ontario. L'Association des enseignantes et des enseignants franco-ontariens, the Elementary Teachers' Federation of Ontario, the Ontario English Catholic Teachers' Association, and the Ontario Secondary School Teachers' Federation are affiliated with OTF.

A pension plan for Ontario's teachers has existed in some form since 1917. For most of the 1900s, teacher pensions were administered by the Government of Ontario; latterly, through the Teachers' Superannuation Fund (TSF). Until 1989, the TSF was entirely under the control of the Government of Ontario through the Teachers' Superannuation Commission. In 1989, the TSF was re-established by the Teachers' Pension Act of the Ontario Parliament as a separate corporation, the Ontario Teachers' Pension Plan.

The Ontario Teachers' Pension Plan (OTPP or "the Plan") is a partnership between the Ontario Teachers' Federation and the Government of Ontario, formed between OTF and the government in 1991, making the OTPP one of the province's first joint-sponsored public sector pension plans. With assets of $106 billion, the OTPP is also Canada's largest occupational pension plan.

Plan governance has two components:

1. Fiduciary responsibility lies with the Ontario Teachers' Pension Plan Board, whose members are charged with overseeing the investment policy direction of the Plan. The Board comprises nine members: four appointees each from OTF and the government, and a jointly appointed chairperson. The day-to-day administration of the Plan is the responsibility of its Chief Executive Officer, Claude Lamoureux, and his staff.

2. On January 1, 1992, the Partners' Agreement came into effect codifying the relationship between the sponsors. The Partners' Committee comprises six members: three government appointees, and three from OTF. The Partners have responsibility for Plan changes and ultimate control of Schedule 1 to the Teachers' Pension Act, the document that sets out the administrative rules for Plan operation, including contribution rates and pension and survivor entitlements.

Since the Ontario Teachers' Pension Plan is a joint-sponsored pension plan, both partners, the teachers and the government, share the good and the bad. This means that when the investments of the pension fund do well and the Plan has an actuarial gain, the Partners negotiate how these gains are spent. If the investments do poorly, the Partners share in the responsibility of making up the shortfall. OTF is the bargaining agent, on behalf of all members of the Plan, in these negotiations.

The Ontario Teachers' Pension Plan was established in a pension universe governed by the *Pension Benefits Act*, (PBA) a law that thoroughly considered employer-sponsored plans, but really did not contemplate joint sponsorship. Through the intervening years since 1990, the Plan operated under a kind of uneasy truce with the regulators, since some of the rules under the PBA, particularly those affecting contribution obligations, really did not match the Plan's real-world operation very well.

In 2005, the Government of Ontario undertook a consultation process regarding the funding of joint-sponsored defined benefit pension plans. As a result of this process, changes were made to the regulatory environment that began to recognize the differences between employer-sponsored and joint-sponsored plans bringing the latter some much needed relief.

Responding to the Ontario Expert Commission on Pensions (OECP)

The Ontario Teachers' Federation welcomes the chance to respond to the Ontario Expert Commission on Pensions. The OECP has enunciated the following principles to guide its work:

- the importance of maintaining and encouraging the system of defined benefit pension plans in Ontario;
- the importance of maintaining the affordability of defined benefit pension plans for both members and sponsors;
- the importance of pension plans in supporting a competitive economy;
- the need to safeguard the security of pension benefits;
- the need to balance the rights and obligations of employers, plan members and pensioners; and
- the impact of demographics and the changing nature of the workforce on the provision of employment pensions.

OTF will not comment on the entire range of questions posed by the OECP in its discussion paper. Rather, we will confine our response to some of the social and regulatory issues it has identified.

The Social Context – Canada's Safety Net

It was government action promoting the conventional model of pensions that brought about a significant feature in Canada's social safety net. Since 1952, Old Age Security (OAS) has promised all Canadians a "modest" retirement income from age 65. OAS has been improved from time to time, for example, by the introduction of the Guaranteed Income Supplement (GIS) in 1967 and later by the addition of indexation in 1972.

For working Canadians, the Canada Pension Plan (CPP) provides most workers with an income based pension. Together, these three elements, CPP, OAS, and GIS, are the foundation stones of public pension policy for Canadians. Canadian tax law makes provision for private individuals to supplement these public elements with personal pension savings in tax-deferred Registered

Retirement Savings Plans (RRSPs) or to participate in a tax-deferred Registered Pension Plan (RPP).

The Social Context – First Principle
OTF believes the work of the Ontario Expert Commission on Pensions must rest on a consideration of the single question that underlies its work – what is the purpose of a pension? OTF continues to believe that the answer is as straightforward as the question – "to provide [Ontarians] with an adequate and secure income in their retirement."

Although a debate concerning this purpose has arisen within some quarters of the membership where pensions are viewed as a simple benefit for which members have contracted and to which they are entitled without restriction, the OTF Executive's position is that the more conventional view of pensions as part benefit, part social engineering applies.

For us, retirement implies the cessation of work and the opening of the door for the renewal of the profession. Some retired members may continue to return to work as occasional teachers, but that return is governed by restrictions specified by the Partners within the plan text. While other ancillary purposes for pensions certainly exist, particularly as a tool for employers in the recruitment and retention of employees, it is this single principle of allowing a dignified retreat from the world of work that drives the remainder of the discussion.

The Value of Defined Benefit Pension Plans
The OECP asks the question, "What are the unique attractions of defined benefit plans?" (4.1) Of all possible retirement schemes, Defined Benefit (DB) plans satisfy the first principle best.

The Pooling of Risk
By pooling the most significant risks of retirement saving – investment and longevity – DB plans allow their members to build a secure retirement nest egg in ways with which neither individualized corporate alternatives such as Defined Contribution (DC) plans nor private alternatives such as Registered Retirement Savings Plans can compete.

The value of pooling investment risk cannot be overestimated, and the larger the pools, the better, since the law of large numbers suggests that larger pools will closely approximate the mean. In simple terms, this means that a single bad decision in the investment of one's RRSP can do irreparable damage irrespective of the diversity of one's individual portfolio, whereas a large DB plan should be specifically managed so as to mitigate those risks.

Moreover, as OTF's involvement with the Ontario Teachers' Pension Plan has shown us, there are unquestionable advantages to scale. Because of its size and the pool of capital available to it, the OTPP has investment opportunities and, as a result, an ability to generate returns that the average worker could never hope to match.

The same economies of scale are true of longevity risk, since an individual RRSP holder who has carefully planned a retirement to age 83 and who subsequently lives to age 93 may find his or her circumstances significantly reduced. Large plans, however, pool that longevity risk by acknowledging that while some members will die sooner, and some later than expected, most will live a reasonably predictable lifespan. As a result, those who do outlive the average will not find themselves deprived of their financial security.

Other Advantages

Among the other advantages provided by DB plans, two stand out:

1. the automaticity of the saving; and
2. the relief for the member from the need to manage it.

In the case of the OTPP, membership is mandatory and automatic. All teachers, principals, and administrators who work in Ontario's publicly funded school system are members. Every school board deducts the required pension contributions and remits them to the OTPP. As the employer, the Government of Ontario matches those contributions in the aggregate – dollar for dollar. At the current contribution rates, the result is that every member contributes an average of 10% of salary (9.3% up to the Year's Maximum Pensionable Earnings and 10.9% above it). Including the government's matching share, members set aside 20% of their annual income against their future retirement.

Were it not for the automaticity of this process, it is doubtful that members would be inclined to make such a heavy investment in their future welfare. Evidence suggests that in the private world of RRSPs, the preponderance of investment comes from high earners; while low earners, like their early career teacher counterparts, can always find exigencies that appear more urgent than saving. In the RRSP game, the advantage is clearly to those who can already best afford it.

Participation in a DB plan also relieves individuals from the burden of self management of their principal source of retirement saving. The marketplace is a dark and dangerous place for most. Picking one's own portfolio, or even picking reliable mutual (pooled) funds, requires significant effort in a somewhat esoteric field. Teaching OTPP members how to manage their own investments would be akin to teaching those with a toothache to do their own extractions – some might manage the process quite well, but for most, it would be a painful and hazardous experience.

Moreover, because of the clarity of the promise made at the date of hire, DB plans provide their members with a working lifetime of stress relief by freeing them from doubts about how they will sustain themselves once they can no longer work.

The Public Policy Question – Making DB Plans More Widely Available

Some within the DC world talk about the advantages of self management and the availability of "safe harbour" investments in many DC plans. OTF believes that a DB plan, well managed, has provided the best of all possible worlds for our members; the guarantee of a clearly defined and inflation protected pension benefit. For thousands of Ontario workers, the story is very different. Since neither DC plans nor personal retirement planning through RRSPs can approximate that guarantee, workers seeking a comfortable retirement must work longer and save more.

Perhaps public policy in Ontario should facilitate the establishment of one large multi-employer jointly-sponsored DB plan or several plans to which workers and their employers would contribute throughout their working lives. A modest replacement rate of 50% could be the aim. One of the keys would be portability similar to that of the CPP, so that no matter where one worked, one's pension accrual and entitlement would follow.

A Cautionary Note

A notion often floated by some within the pension industry is that of unlocking pension contributions, either at the time of retirement, or along the way to it. The releasing of those locked-in funds, so the argument runs, would provide additional capital with which the marketplace would grow the economy. OTF believes that such a restructuring would be poor public policy. We have already written about the significant advantages of working within a pooled environment, and of the recognition by many of the benefit of being relieved of wealth management.

Locked-in pensions are also a defence against the overburdening of the safety net resulting from the actions of those who might otherwise take their money out. The scenario is essentially a retelling of the grasshopper and the ants – the member whose personal retirement planning consists of a weekly trip to the lottery kiosk for the purchase of a 649 ticket. If late career or early retirement individuals squander their resources, their options may be reduced to three:

- Return to work forever
- Live in penury on the public purse
- Die

The Regulatory Environment

Surplus Accumulation

The traditional view of labour is that such surpluses as accrue in employer-sponsored DB plans are the property of plan members. Pension plans and plan improvements are the product of vigorous collective bargaining where, in the end, the contributions companies agree to make are based both on the bargaining itself and on the costs predetermined by their actuaries. Because actuaries are conservative in their costing, employers may reasonably assume that surpluses will eventually arise. Nevertheless, they have agreed to fund at a particular level.

The underlying principle runs as follows – pensions are a form of deferred wages whether employees contribute or they don't; therefore, any interest or surplus that accumulates on that deferral is the property of those on whose behalf the deferral was made. It is compelling logic. If one owns a share in some other pool of money – a mutual fund for example – one also owns a proportional share of the returns generated by the fund. Canadian courts have increasingly given employees rights concerning surpluses.

Employer sponsors justify their reluctance to build surpluses in their plans by the absence of a clear definition of to whom the surpluses belong. They would argue that our earlier analogy breaks down since mutual fund shareholders also own a proportional share of the liability. If a mutual fund does not do well, losses are distributed among the shareholders. In pension plans, employer sponsors regard themselves as owning all of the risk for shortfalls with no opportunity to share in surpluses.

Because of this perception of asymmetrical risk, employers are inclined to only fund to the minimum mandated level, and to keep any cash that might go to building a surplus within their ongoing operation by taking contribution holidays at the earliest opportunities – a significant impediment to achieving pension promises cushioned against catastrophe. But by not making their agreed-upon contributions during contribution holidays, employers are receiving de facto access to surplus.

In contrast, plan members could argue that they do indeed bear the ultimate risk – plan insolvency resulting from the underfunding of plans. DB plan members bear two additional risks:

- the risk of conversion as employers seek to control costs; and
- the risk of wind-up as employers simply abandon pension coverage altogether.

The latter simply exacerbates the lack of coverage discussed above.

In non-indexed pension plans, surpluses arise in many cases from the conservatism of their funding. The mismatch between nominal rates of return that have an inflation component and liabilities that have none will eventually lead to surplus accumulation. In other words, if employers fund according to conservative actuarial assumptions and do not take contribution holidays, surpluses are inevitable.

A possible solution seems to come from the kind of joint-sponsored arrangement OTF and the government have developed through their Partners' Agreement. The OTPP is a fully indexed plan in which the Government of Ontario (acting for the employers) and the Ontario Teachers' Federation (acting for the membership) share both surpluses and deficiencies equally.

The Valuation Puzzle

Pension plans are subject to two kinds of valuations. The first assumes that the sponsor will continue as a going concern and, as a result, the employer will be around to respond to fluctuations in funding levels as they occur. The second assumes that the enterprise will wind up and should, therefore, be subject to a solvency test for the protection of its members. The regulatory environment does distinguish the varying probabilities among sponsors that they will cease operations.

In the case of the public sector, solvency may be an unreasonable standard. Using the OTPP for argument's sake, what would be the probability that the public education system in Ontario would cease to operate?

Valuations done during difficult economic times when asset values are depressed temporarily may reveal a solvency deficiency that the sponsor must then address. But once the sponsor is committed to a funding level that becomes excessive once asset values recover, without access to the surplus to recoup a portion of the overpayment, the sponsor's costs have been raised inappropriately.

OTF believes that both of these factors need re-examination. Pension plans are long duration propositions. It is not unreasonable to allow funds to run significant surpluses during good times since it is simply economic reality that good times will be followed by bad as the economic cycles ebb and flow. Nor is it unreasonable to share both the risk of deficiency and the reward of surplus in some proportional way thereby lowering the impediments to funding at more than the minimum, provided that the sharing is done within the context of joint sponsorship.

Pressure on Decision Makers
Another source of plan stress is the role of the actuary in valuing plans. OTF believes that given the wide variation in actuarial practice from plan to plan or firm to firm, more thought should be given to the development of a national (or at least provincial) standard. When times are difficult, actuaries can find themselves under considerable pressure to produce the valuation that sponsors want to see. The future security of the plan in question, and therefore of its members, depends on the quality and accuracy of the valuation. Greater clarity of expectations and practice would seem to promise a truer assessment of a plan's health.

Clarity in Regulation
The PBA and its attendant regulations are enormously complex. OTF believes that any action that would bring clarity and greater simplicity would be beneficial. We would single out three areas of concern that have a direct and immediate effect on our members:

1. Marriage Breakdown
   One of the most frequent complaints by members who find themselves in a dissolving marriage is the time and expense caused by the current framework. The process can often take months and just as often leads to bitter fights between spouses and their lawyers and actuaries as the disputes are resolved.

2. Portability
   The transfer of pension entitlements in the current environment is difficult. Little flexibility exists so that individuals can find themselves with several small but vested pensions with no way to consolidate them. Were the Commission to consider recommending the development of some large and widely available multi-employer plan as OTF has suggested, there is a clear need to solve the portability issue.

3. Shortened Life Expectancy
   While the inclusion of shortened life expectancy provisions in the PBA is a step in the right direction, more thought needs to be given to what the correct solution ought to be for those already drawing pensions.

In addressing the regulatory environment, the Commission would do Ontarians a great service by encouraging clarity and even-handedness throughout.

Summary

The Ontario Teachers' Pension Plan and the joint sponsorship agreement that underpins it are excellent examples of how careful oversight, prudent but innovative investment strategies, and a carefully tailored pension promise can combine to very positive effect. Ontario's teachers seem well aware of the quality of their plan. Moreover, they have an ever deeper understanding of the security that their plan provides. They face neither the prospect of living out their post-retirement days in reliance on Canada's social safety net, nor of seeing their retirement means eroded as inflation takes its toll.

OTF urges the Ontario Expert Commission on Pensions to consider making the following recommendations:

1. That the government investigate the concept of a universally accessible, multi-employer, defined benefit pension plan for Ontario workers for whom access is not currently available.

2. That the government encourage Defined Benefit plans to investigate joint sponsorship as a way to bring about fair risk and surplus sharing thereby providing incentive to fund plans fully and to develop surpluses.

3. That the Government of Ontario lobby the Government of Canada for reforms to the Income Tax Act that would eliminate the current cap of 10% on surplus accumulation, the better to guard against future economic pressures.

4. That the government begin an intensive review of the PBA and its regulations with a view to clarifying and simplifying the regulatory environment.

5. That the government press for universal standards of practice for the actuarial profession so that all future valuations would be done in a consistent and prudent manner.

6. That the government ensure adequate public consultation prior to future regulatory change so that plan members and the pension industry have input into policy making.