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Jim Leech
Retired President and CEO, Ontario Teachers' Pension Plan

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CONFRONTING OUR PENSION FAILURES

Chairman: **Noble Chummar**
President, The Empire Club of Canada

Head Table Guests

Verity Sylvester, Director, CV Management, and Past President, The Empire Club of Canada; Keith Ambachtsheer, Director, Rotman International Centre for Pension Management; Kent Emerson, Director of Operations, Office of the Hon. Charles Sousa, Ontario's Minister of Finance; Julie Pauletig, President, Ontario Teachers Federation; Mike White, President and CEO, IBK Capital Corp.; Bill McFarland, CEO, PricewaterhouseCoopers LLP; Tom Kloet, CEO, TMX Group; William White, Chairman, IBK Capital Corp., and Director, The Empire Club of Canada; Ian Russell, President and CEO, Investment Industry Association of Canada; Eileen Mercier, Chair of the Board, Ontario Teachers' Pension Plan; Noel Archard, Head

Managing Director, Blackrock Canada; Philip Crawley, Publisher and CEO, The Globe and Mail; and Stephen Dekuyper, Chaplain, King-Bay Chaplaincy.

Introduction by Noble Chummar

While we are a club deeply rooted in history, nobody can ever accuse the Empire Club of not being ahead of the curve when it comes to current affairs of this nation. It was only this past Wednesday that the Premier of Ontario appointed former Prime Minister Paul Martin to investigate the feasibility of an Ontario Pension Plan.

Today's talk is about pensions. Financial security is the means to many of our necessities of life. We are a nation that is concerned with the welfare of our fellow citizens.

In 1963, at this very podium, the Right Honourable Lester B. Pearson, Prime Minister of Canada, outlined his vision for the Canada Pension Plan. The prime minister believed that all Canadians, regardless of means, should be entitled to a basic pension, bridging the distance between dependence and dignity.

To introduce our speakers today, please welcome Mr. Tom Kloet, Chief Executive Officer of the TMX Group.

Introduction by Thomas Kloet

Thank you, Noble. Good afternoon everybody. Since 1903, the Empire Club has played an important role in national and international debate. If a subject matter is important, we know that at some point it's going to be discussed right here at this forum by people who really know the subject and what's going on. There are few more timely issues to discuss than today's subject—our pension system. I'm truly privileged to have the chance to introduce today's speakers.

Jacquie McNish is a senior writer with the Globe and Mail. You'll also recognize her from her work as a host on BNN. Jacquie is an award-winning business journalist. She has won six National Newspaper Awards, and is the author now of three best-selling books. She also teaches a seminar, Investor Rights and Shareholder Activism, at Osgoode Hall Law School. It's great to have Jacquie here to share her insights with us today.

Alongside Jacquie, we have another familiar face to many of us, Jim Leech. Jim retired as president and CEO just a few weeks ago after more than 12 years at the Ontario Teachers' Pension Plan, one of the largest pension funds in the country and a major investor worldwide. Jim's career highlights include leadership roles in the realm of private equity as well as several public companies. His experience is spread across a broad spectrum of the Canadian business landscape at each phase of a company's life cycle.

Jim has led a merchant bank, an integrated energy and pipeline company, and he has helped technology startups navigate through the challenging early stages of development.

The pension issues inevitably impact the lives and careers of all Canadians. Unfortunately, it is also a problem that few are willing to face, and one that fewer still have the temerity to solve. Tackling this subject matter is an enormous challenge, but Jim and Jacquie have done just that and, importantly, raised the quality of this discussion along the way.

With that, I will let them tell you more about the book, the hard lessons we need to learn and, importantly, the necessary steps we need to take to work our way through this problem. Jim and Jacquie, thank you.

Jacquie McNish

It's the first time we've talked about pensions sitting in thrones.

Jim Leech

Thank you very much, Tom.

A little bit of background. A motivation for this book was the frustration that both of us had back in 2012 as we saw the pension debates start to evolve. We felt that they were really focused on the wrong areas. They were focused on things such as pension envy, this fruitless debate of defined benefit versus defined contribution, and we felt that this really was more a story of people arriving at retirement with insufficient savings, particularly in an environment where longevity keeps increasing and interest rates and returns are low.

We set out to write "The Third Rail" as a book dedicated or aimed at educated Canadians who want to engage in the debate, but they are a bit bewildered, overwhelmed, and frightened by the whole subject. We wanted to try and make it simple. It's 180 pages, small format, large print. If it takes you three and half hours to read it, you're kind of slow. It's written as a series of short stories. It does not have an economic tone. There are no charts and graphs and tables, etc. Even my children said it was quite engaging, and that's a compliment.

Anyway, pensions are on the top of the agenda these days. They're on the verge of becoming very significant election issues. They're dominating and have dominated the politics and elections in three jurisdictions—New Brunswick, the Netherlands and Rhode Island. As Tom mentioned, they are probably going to become an issue in the next Ontario election, if not the next Canadian election. Why is that? Well, it's the simple fact that 40 per cent of our work force, some seven million workers, will be retiring in the next 20 years. Generally speaking, they haven't saved enough. Sixty per cent of our work force today does not have workplace pensions, RRSPs have been a dismal failure, people are living far longer than they ever expected, and many of our existing pension plans are not sustainable. We called it "The Third Rail" because that's, of course, the electrified rail in the subway that everybody is afraid to touch because you'll get killed if you touch it, but it is time that our leadership does grab that third rail and start confronting this issue.

Jacquie McNish

Jim has talked about the leadership vacuum that exists in Canada and in many other countries. It is a career killer. That's the perception, politically. We are starting to see this change when there are more urgent and pressing pension crises in various regimes.

What happens to the debate when there's a leadership vacuum? We strongly believe it's badly misinformed and it's defined today in Canada and many other countries by pension envy. Sixty per cent of Canadians don't have pensions. The majority of those that do are public sector workers. Taxpayers feel that they shouldn't be there. You've got younger generations; we've got young students from Centennial College here. I wish you luck. You'll be propping up a lot of pensions of older people that, if we don't change things, you won't be getting. There's inter-generational risk. You have the haves and the havenots.

The best way that I can tell you about what this means, what

the debate means and how misinformed it is, is with a fable that I heard when I was in Central Falls. One of the chapters and case studies we do is Rhode Island, which really was in a crisis state. It had gone over the cliff as a result of pension deficits. In Central Falls, they declared bankruptcy. It became a very ugly situation between the taxpayers and the pensioners, most of them police workers, fire workers and municipal workers. The taxpayers had seen their property taxes rise as the city coped to deal with this, not by rolling back the benefits or creating a more sustainable pension system. They cut services. They raised taxes. The taxpayers were done.

I met this woman who had been a consultant in Russia with McKinsey & Co. for years and came back to her home state, Rhode Island. She said, "I thought Russia was messy. This place is really messy." She said, "I heard a fable once that best describes what happened here with the pension crisis." If you know anything about Russian fables, they love the golden fish. The golden fish is a magical creature in the fables.

The fable goes like this. A poor farmer only has one cow. He and his wife beat out a very meagre existence. One day, the cow dies. He's distraught. His livelihood has disappeared. His wife says, "I can't take this anymore. Stop the kvetching; go out and go fishing." He goes fishing and, lo and behold, he pulls up a golden fish. The golden fish says, "I'm a golden fish. I can grant you any wish you want. What would you like? Please save my life and you will get this wish." He thinks about it for a long time, and then kind of a nasty smile crosses his face. He says, "I know what I want. I want my neighbour's cow to die."

That's the pension debate today. That is the most dominant pension debate. The people here know this, because they know that they want to take away the public sector defined benefit because they don't have it. They feel that taxpayers are paying for it. Jim got me hooked on this book because he told me how wrong that thinking was and, in fact, how the math just didn't add up. I'm going to hand the conversation over to Jim, and he's going to tell you why that farmer in Russia is wrong.

Jim Leech

The book concludes with three recommendations. I'll tackle the first one that Jacquie's thrown out as a challenge and that is the fruitless debate between defined benefits and defined contributions. One of the points we make is we need to stop this migration that's gone on from defined benefit to defined contribution. Why is that? It is irrefutable, mathematically, that the defined benefit structure for a pension plan is far less expensive than the defined contribution structure. That is probably piercing a whole bunch of urban myths because, in many quarters, defined benefit is bad and defined contribution is good. It's really a question of where the risk is placed but, mathematically, it is far less expensive to have a defined benefit plan. The reason for that is that you can pool all sorts of risks. Investment risk, but more particularly, the longevity risk.

In a defined benefit plan such as the Ontario Teachers' or others, we need to save up enough money to get to the actuarial mean of when it's predicted that people will die. If you're in a defined contribution plan, it's every man for himself. You basically have your own little account and you must save enough money to last to the very far righthand side of that actuarial curve. If you're going to live to be 105, you don't want to run out of money when you're 102, because the last three years won't be a lot of fun.

We spent a fair amount of time in the book piercing that urban myth and explaining that the defined benefit model is the superior model. However, that's not to say that we defend the stereotypical 1970's defined benefit plan that was built. There needs to be a far more appropriate sharing of risk and cost as between the sponsor, aka the employer, and the employee.

We talk about target benefit plans. We talk about hybrids. We talk about evolved plans. We're talking about keeping the basic structure of defined benefit because it's so efficient and effective, but introducing a risk-sharing concept.

Here are some fast statistics about the defined benefit plans that we picked up in our research. Interestingly enough, for recipients today in Canada, there's approximately \$68 billion to \$72 billion paid to retirees from existing defined benefit plans. Those retirees pay somewhere between \$14 billion and \$16 billion in taxes. Everyone always thinks that the dollar that goes out on a pension is kind of lost, but retirees pay taxes. They spend on the economy somewhere between \$56 billion and \$63 billion. Approximately 11 per cent of the income of every small community in Ontario is the income of a defined benefit pension recipient. It's a huge component of our economy.

One last fact before I turn it back to Jacquie is in looking at the defined benefit model. There's always this perception that the taxpayer is paying for this, etc. The facts of the matter are that around somewhere between 20 per cent and 25 per cent of the dollar that goes out as a pension payment comes from contributions. In the case of teachers, approximately 12 cents comes from the teacher who paid in and 12 cents comes from the employer. The balance, 75 per cent to 80 per cent, comes from the investment returns. It's a very, very efficient model.

The alternative is the Guaranteed Income Supplement (GIS) and the Old Age Security (OAS) payments. Those come out of general revenues. Every dollar comes right out of the taxpayers' pockets. Right now, OAS and GIS represent the single-largest line item in the federal government's budget. It's \$38 billion. By every projection it will triple in the next 16 years. That's what we're trying to avoid.

Jacquie McNish

Jim's given you some very important numbers to sort of lay out the landscape. We can either deal with it now or deal with it later, and pay more as taxpayers. Pensions are more than numbers. Pensions are about people. What we discovered in doing our research for the three case studies— New Brunswick, Rhode

Island and the Netherlands—was that it takes people to fix this problem, and it's the people who are affected by this problem. In each of these regimes, we discovered extraordinary people—outliers, mavericks who were willing to approach this from a very different point-of-view—overcame hurdles, biases and resistance, constant resistance, to do what needed to be done.

The first one I'm going to tell you about is New Brunswick in our backyard. New Brunswick is what we call ground zero in Canada's pension crisis because the children of the baby boomers left a long time ago. This is a have-not province, resource-based. They had to leave the province to get jobs. The pension crisis hit New Brunswick faster than any other province in the country. You layer in the crisis with pulp and paper and other resources; it's a grim situation. The financial crisis hits and the province of New Brunswick is looking at a downgrading. You know what a downgrade means to a government. It's just going to cost them a lot more to pay for everything.

The extraordinary thing about New Brunswick is that it was heading towards a cliff. People had public sector pensions they could no longer afford. The people who were the catalyst for the reform were in the unions. They worked with the Conservative premier, which is truly an extraordinary thing if you think about it. It involved one nursing union and one hospital workers' union, where they were looking, after the 2008 financial crisis, at potentially— I may have my numbers slightly wrong—I believe a 60-per-cent increase in their contributions or up to a 50- per-cent reduction in their benefits. They were looking at not retiring when they hoped to and massive reduction in their benefits. There were a lot of complicated ins and outs in terms of what they did in the courts and the jurisdictions, but they worked with David Alward, the Premier of New Brunswick, and they resolved this problem.

David did something very interesting. He made it voluntary for the various public sector unions and groups to join in if they wanted to, rather than ramming it down their throats. It was sort

of a fairly calculated move because he knew they needed help. If they wanted to be part of this model, they were going to have to come in. It's still a fight. It still grabs the headlines in New Brunswick, but more and more of the public sector groups are coming in.

At the end of the day, what do they have? They have what Jim referred to as a shared-risk model. If you are underfunded under the shared-risk model, the beneficiaries, the members of the pension fund, give up benefits. The quid pro quo in this relationship is solvency. You can no longer be underfunded. You have to be fully funded. There's just no wiggle room like there is today for many funds. The worker gets the security of a more sustainable pension plan and allows the employer to temporarily suspend such benefits at cost of living if they can't afford it, if they're under-funded.

Jim Leech

My favourite part of the book is the Rhode Island story. As Jacquie said, it's about people. The lead character is a young woman who's the state treasurer. Her name is Gina Raimondo. She grew up in a poor family in Rhode Island, went to public school, took the bus, studied in libraries, etc. She went off to Yale, Harvard and Oxford. She came back and had a successful venture capital operation on Wall Street.

She read in the paper about bus routes being closed and libraries being closed, etc. She said, "People will not be able to live the American dream that I did unless that's fixed." She left her job, decided to run as a neophyte, had never run before, on a platform of pension reform. She was advised against it by everybody in the Democratic Party right up to the White House, but she did it and she won in a landslide.

She produced a document called "Truth in Numbers." She held a countless number of sometimes very hostile town hall meetings explaining in a very dispassionate way how reform was required, etc., and eventually got it through the legislature, even though the governor didn't necessarily support it to begin with. It is an interesting name. Keep it in the back of your mind. You'll probably see her run as governor. I wouldn't be surprised if you see her in some capacity in the White House in the future. This is a real dynamo and someone who had the guts to grab the third rail with both hands.

Jacquie McNish

One of the things we learned from meeting with Gina Raimondo was how she dealt with what is arguably the toughest political issue or employer issue in the pension debate, and that is it's immoral to change the terms of the contract. She would look the very angry retirees and union leaders in the eyes and say, "No. It's immoral to close the schools, to stop the buses." It's a very interesting approach. They were in crisis. It's not going to be the same for everyone.

Jim is about to give you his top-three reform proposals, which truly are the heart and soul of the book. I want everyone to think about questions. You have a unique opportunity here to talk to one of the country's best experts in pensions. We've had very robust discussions with every group we've talked to, and we hope you folks will continue that tradition. Here comes the top three.

Jim Leech

The last chapter has the three recommendations. The very first has to do with our concern for people who are earning $30,000 to $100,000 a year. If they're depending on Canada Pension Plan, OAS and GIS, they're in for a big shock in how their standard of living will change. Our recommendation is for a modest increase in the Canada Pension Plan. There are all sorts of different models that have been put forward. We mentioned one that we think works in the book, but we're not wedded to it, which would see contributions to Canada Pension Plan phased in over time increase from about $2,300 to about $2,900. We don't believe that that's a huge hit. It's basically aimed at people who are at

an income level well above the average of the workers whose employers are members of the Canadian Federation of Independent Business. It shouldn't really impact them that dramatically.

The second one is what I talked about before—to stop this foolhardy migration from defined benefit to defined contribution, and see an evolution to the standard defined benefit programs so that, indeed, you have something that is sustainable and secure for employees.

Our third tries to address the 60 per cent of Canadians who do not have workplace pensions. The federal government and most of the provinces are picking up on a new plan called PRPP, but we think it needs to be changed. Some different elements need to be added to that because we don't think it'll work as it is. It's just another four-letter word as opposed to RRSP, which we know has been a huge failure. In this recommendation, we would see that contributions and membership would be mandatory because people will not save if it's voluntary. Secondly, there needs to be far greater emphasis on cost control and keeping down the costs of administering and managing the pensions, which likely means larger pools. The third is this. In a defined contribution model, you don't find out how much money you have to live on until the very last day. The very last day, when you retire, you open the box and you find out how much money you've got for the rest of your life. We believe that, say starting around age 40, some portion of your defined contribution savings need to get annuitized into deferred life annuities so that when you get to that magic day, as I did 24 days ago, you do know that you've got a certain amount that's guaranteed for the rest of your life. It takes that anxiety out of the equation.

Those are our three recommendations. We don't think they're terribly revolutionary. This subject has been studied time and time again. It's now time to take action.

The appreciation of the meeting was expressed by William White, Chairman, IBK Capital Corp., and Director, The Empire Club of Canada.