

Is bigger better? or, How to solve Ontario's pension problem

John Crocker, President & CEO, Healthcare of Ontario Pension Plan
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Thank you very much for inviting me to speak to the Pension Summit today; and thank you David and Martine for the kind introduction.

HOOPP has been in business for fifty years, providing Ontario's healthcare workers with defined benefit pensions.

Traditionally, we have not sought a loud public voice. Of Ontario's large pension plans, we have been the quiet one. Recently that has changed. The reason for that change – and the reason I wanted to be here today to address the Conference Board Pension Summit - is to sound the alarm about an emerging retirement income crisis.

I'd like to focus on the aspect of this complicated issue that I know best. In a Globe and Mail survey of Canadian C-Suite executives, two points were agreed on. First, defined contribution plans will not generate secure retirement income for workers.

Second, business cannot afford defined benefit plans that would offer that security.

A survey conducted for HOOPP by the Gandalf Group earlier this month shows that 86 per cent of Ontario adults surveyed agreed that there was an emerging retirement income crisis.

I'd like to share a couple of stories about security. Last year, at a HOOPP stakeholder conference at the Deerhurst Resort, I met a number of workers who were about to retire.

They had not been in high paying jobs during their careers. But they had tears in their eyes when they said that the best thing that they had ever done in their working lives was joining HOOPP.

They were secure – their HOOPP pension, plus government pensions would replace much of their working income. They were going to enjoy their retirement years.

More recently I learned of a highly regarded physician – one who is considered by many to be world-class.

He was in his early sixties, and had been highly compensated throughout his career. But he can't retire. He hadn't saved enough, did not belong to a pension plan, and was going to have to keep working, possibly for many years to come. Do you want to be operated on by an 80 year old surgeon?

The view that we can no longer afford defined benefit plans is quickly becoming conventional wisdom. The entire debate about pension and retirement income reform seems to be taking place on the mistaken assumption that defined benefit plans are not part of the solution.

I believe that is dead wrong.

It's dead wrong that we can't afford them.

And it's dead wrong that we can achieve our goals without them.

My experience with HOOPP has convinced me that defined benefit plans are viable, affordable and must be an integral part of providing retirement income security for Canadians.

Let us begin by looking more closely at the pension crisis.

There are three things behind this emerging problem.

First, there's a tax system that is more effective at encouraging upper income earners to save than it is for middle and lower income earners.

Second, companies are shifting from defined benefit to defined contribution plans, group RRSPs, or even no plan at all.

Third, many Canadians put off saving for retirement until it is too late.

When I look at these three problems, I worry that as a country we are undoing decades of success at raising the standard of living for retired persons and shrinking the scourge of elderly poverty.

HOOPP's recent survey of Ontarians found that 84 per cent of respondents were concerned about whether they have saved enough for retirement.

Most of the C-Suite executives of the largest companies in Canada told the Globe and Mail that "our pension system is facing a crisis in which working people today will not have enough money to live on in retirement."

Now if that's not a wake-up call, I don't know what is!

Many studies show Canadians are not saving enough for retirement on their own.

The harsh reality, according to many industry observers, is that you need \$20 of savings for every dollar of retirement income you want to receive.

So if you want income of 50,000 dollars a year, you need to save a million. If you want 25,000 dollars a year, you need half a million.

RRSPs aren't doing it. The average Canadian has about \$60,000 in RRSPs at the time of retirement.

Most people with only RRSP savings need to look to the Canada Pension Plan, OAS, and GIS for additional income. All three offer a very modest monthly benefit.

Elder poverty, now that the boomers are retiring, is becoming a concern. Dr. Ellen Gee of Simon Fraser University has written persuasively about this issue. By 2040, 23 per cent of the Canadian population will be over 65.

Now, she says, is the time for us to think very carefully about the kind of retirement income system we want. She cites the importance of collective responsibility and shared risk, rather than letting the market be the arbiter of individual and social well-being.

The retirements of baby boomers, she concludes, could be a force that leads to unacceptable levels of public spending – so we must fix things now to avoid a fiscal crisis in the future.

Statistics Canada confirms what we all know – the last twenty years have seen a steady shift of retirement income risk from employers to workers. And the recent market crash has shown that risk can fall disproportionately on people who happen to be nearing retirement at a down point in the market cycle.

While the amount of discussion centring on pension reform and retirement income fixes is welcome, nothing I have seen on the table will solve the problem of both pension coverage and adequacy at the same time.

Everyone in this room knows that we are facing a real problem.

However, the best, and perhaps most obvious solution – the defined benefit pension plan – is being overlooked, or prematurely dismissed.

The only argument in favour of defined contribution plans over defined benefit plans lies in the alleged lack of affordability of DB plans. Let's examine that, from both the employer perspective and from the societal perspective.

I've been leading a DB plan for 10 years, including through the tech wreck and the recent market meltdown. I am convinced that defined benefit plans are an affordable and essential component of private sector retirement income.

A 2008 study by the U.S.-based National Institute on Retirement Security found that DB plans are more affordable than DC plans, and can deliver a targeted benefit for 46 per cent less. That's because DB plans have professional investing, pooled longevity risk, and are ageless – designed to run over the long term.

Our survey found that 67 per cent – that's over two thirds – of respondents were interested in being part of a DB plan. Only 35 per cent were interested in being part of a DC plan.

With a DB plan, experts invest the money. With DC, it's like self-surgery – the employees are expected to make their own investment choices, or there is a default choice. So a member choosing a money market fund to avoid losses misses out on gains.

Professional investing is important. At HOOPP, and typically in our industry, the vast majority of every DB pension dollar comes from investment returns. The rest comes from the contributions themselves.

With both types of plans, employers usually match the contributions made by the employees.

The difference is the responsibility for funding any shortfalls. And here, the rules are mismatched – the employer is responsible for deficits, but the Plan members own the surplus. That in itself is a serious disincentive for employers when thinking about offering DB plans.

But that is something that can and should be addressed through rule changes, before one decides that adequate and reliable retirement income is not affordable for our citizens.

HOOPP's members are not rich.

They are the nurses and other working people who provide us with healthcare. They aren't wealthy when they are working, and they are not wealthy in retirement.

Yet they have peace of mind while working and a decent standard of living while retired because they have an annual retirement income that is adequate and they can rely on it to be there for as long as they live.

This allows people to choose healthcare careers with confidence.

This allows our society to hold its head high about how it treats its healthcare workers. And this saves taxpayers money in pension and other income supports they would otherwise have to pay to retired workers with no pension.

I believe providing a respectful amount of retirement income for retirees is a worthy objective for our society – and it is within our grasp.

The general consensus in the industry is that people need to replace 60 to 70 per cent of their working income in retirement. In fact, 76 per cent of the people we surveyed agreed that the government should ensure that companies that offer pension plans have plans that can replace at least 60 per cent of their working wage.

A typical DB plan's goal is to provide replacement income equal to 67 per cent of earnings. There's no such target for a DC plan.

A DC plan member, at the end of a long career, typically has about 20 per cent replacement income. Can anyone be reasonably expected to live on this amount through their retirement? Which type of plan would you rather have had if you were retiring at the market bottom in March 2009?

Here's an example. It's a tale of two families.

Mary and her husband Frank both make \$50,000 – and both have DC pensions. After 30 years on the job, they'll each receive a pension of \$10,000 per year, for life. That's only 20 per cent of their pre-retirement income. They'll need to keep working, or rely heavily on government programs, to make ends meet.

Sarah and Jerry next door make the same money, and have been on the job with a DB plan for the same number of years. They'll each receive pensions of \$30,000 annually, for life. That's 60 per cent of their pre-retirement income replaced, not including government pensions.

More DC plans, or their variants, may solve a narrowly defined “pension coverage” problem in Canada. But if one is looking to solve the retirement income crisis that looms ahead, DC plans will not do it.

Well run defined benefit pension plans will. Let me share a few elements of HOOPP’s recipe for success with you now.

HOOPP’s been paying out a promised benefit for more than 50 years – and at no time have market conditions prevented HOOPP from paying pensions to our members.

We have world-class in-house investment experts to manage our investments.

We have skilled pension administrators who are focused on excellent client service.

We have more than 300 employers – so the liability risk is not carried on any single employer’s shoulders, or balance sheet.

This addresses some of the problems that single employer pension plans face, such as the distribution of risk, and the long time horizons that defined benefit pension plans must operate with. The members of our Plan are also its owners – as are all of us who work for HOOPP. We’re a non-profit trust fund, the largest private trust fund in the country.

With \$31 billion in investments, we have the scale to manage money more cheaply than smaller plans. Our management cost works out to about 32 basis points – a far cry from the hefty fees charged by for-profit retail mutual funds. There are no fees charged to our members, leaving more money to be paid out in pension benefits.

Our focus is stability. We haven’t increased our rates in almost ten years. The goal is to keep contribution rates and benefits stable.

We are very focused on managing risk properly. We use a world-class liability driven investing strategy to ensure that our investment activities map to the income needs, or liabilities, of our membership.

And our focus is 100 per cent on the more than 250,000 Ontarians who are depending on us for their retirement benefits. We aren’t much for pension empire building. We are in this for the long-term of providing for the financial future of those who care for us.

I believe that DB plans are an important part of the pension solution.

Some of these same principles, I submit, can lead us to a true pension solution – and result in a meaningful retirement income for a larger group of Canadians.

I believe that government must act today to allow the formation of large, multi-employer pension plans to provide a pension for workers in the private sector. There is a “sweet spot” that is achieved when plans reach about \$25 billion in assets. This scale allows the funds to achieve economies in their investment practices. It also results in lower management costs for the member and the ability of the plan to distribute risk over many lives and over a 30 year time horizon.

Ninety one per cent of those we surveyed supported the idea of changing the pension rules in Ontario to create more multi-employer pension plans.

These funds could be set up either by sector, industry or region. The multi-employer model provides a number of significant advantages. Where our recommendation differs from others, such as the Arthurs' Commission, is in the type of benefit such plans would offer – we propose DB plans.

The important factor is that the result would be meaningful replacement income, not a process that is ambivalent about outcomes.

Employees would contribute up to 10 per cent of their salary to the pension plan, and employers would match. The liability would not be carried on any one company's balance sheet – which would make participation more attractive for private corporations. No longer would the full weight of funding be on one set of corporate shoulders.

The title of my address today was “Is Bigger better?” and my answer is – sometimes.

It's better when it's the right type of plan, offering the right type of benefits, and at the right scale. We also need to ensure that the right regulatory environment exists to support the successful delivery of an adequate pension.

In order for sectoral pension plans to work where there is the possibility of funding issues, two barriers to private sector participation would have to be dismantled.

The first barrier is funding. There's a disincentive for full funding right now. Employers are allowed to stop contributing when times are good and then hope that the fund takes care of itself through continued high returns. But when market conditions worsen, a 90 per cent funded plan can turn to 60 per cent quickly – and that's going to impact both pension benefits and the corporation's balance sheet. We've seen how that can play out with the Nortel and Abitibi-Bowater situations.

Employers need to contribute steadily through good times and bad.

This would address a related problem – the ownership of deficits. Assuming employers contribute at a steady rate and money is invested by professionals with a targeted strategy, the risk of deficits would be lessened. A deficit would be addressed through such things as increasing contributions, reducing benefits, or a combination of both.

The second barrier is the accounting rules that govern pension plans in this country and province. These need to be fixed if we are to enable more private sector companies to provide pension plans to their employees.

Pensions are designed to provide benefits for the long term, in some cases, benefits are being paid for 30 years.

Yet currently, “mark to market” accounting is used to provide a point in time valuation for a plan's long term investment operations. This creates a technical problem – pension solvency – that doesn't actually impact the ability of private corporations to provide pension benefits. These rules are creating an artificial level of volatility – and I believe it's time to change them.

To conclude my remarks today, let me reiterate that DB plans have an important role to play in solving Canada's pension crisis.

We can be proud of our public pension system – Canada is the only G8 country with an adequately financed public pension system, and HOOPP supports any effort to improve the benefits it offers. But for now, the CPP does not provide a liveable retirement income.

Our research found that 85 per cent of respondents feel the government should ensure that Ontarians have access to an adequate pension income when they retire.

Building a network of large, multi-employer DB plans serving different economic sectors would ensure that more Canadians have adequate income in their golden years. Plans like HOOPP prove that DB is the way to provide citizens with meaningful pensions.

While I'm heartened that debate is occurring in our country about the looming retirement crisis, the focus should not be on pension coverage, but on pension adequacy.

The critical role DB plans can play is being overlooked due to the regulatory disincentives that single employer plans face, and the misguided notion that employees, rather than their employers, should shoulder the risk of investing for retirement.

My call to action is for government to get the rules that govern DB plans right – and to show leadership in encouraging the development of new multi-employer DB plans to serve more Canadians.

Together, we need to fix our pension system so that it looks after the retirement income needs of our citizens. If we focus on the right issue – adequacy – we can build a sustainable retirement system that makes sound business sense and we can meet the critical goal of allowing Canadians to retire with dignity and independence. Thank you.