

**THE MINTZ AND BALDWIN REPORTS ON RETIREMENT SAVINGS ADEQUACY:
AN ASSESSMENT AND POLICY IMPLICATIONS**

December 21, 2009

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Context

On May 25 2009, Canada's Ministers of Finance created the Research Working Group on Retirement Income Adequacy, to be directed by the Prof. Jack Mintz of the University of Calgary. Six research areas were to be covered and the resulting findings were to be "policy neutral". Prof. Mintz presented these findings at the just-concluded Ministers of Finance meeting in Whitehorse on December 18. In addition, the Government of Ontario commissioned labour economist Bob Baldwin to conduct a separate study on retirement savings adequacy. Given the high level of public interest in pension reform, and given my long and deep involvement in the topic, I offer the following assessment of the Mintz and Baldwin Reports, and what they imply for Canadian public pension policy going forward.

Mintz Report Makes Many Important Points

The Mintz Report makes the following important points that bear repeating:

- By global standards, Canada's retirement income system performs reasonably well today.
- Public pensions are a major strength, providing retired low-income workers with close to 100% earnings replacement rates.
- To maintain their standard of living in retirement, retired middle- and high-income workers do not need anywhere near 100% earnings replacement rates. For most, 60% will do, as the kids are on their own, consumer durables have been acquired, the mortgage is paid off, employment-related expenses have ceased, and retirement savings should have been accumulated.
- The majority of workers without employment-based supplementary pension plans appear to be on an adequate retirement savings track.
- A significant minority appears not to be on such a track, and is thus exposed to the risk of either a significant post-retirement drop in living standards, or working considerably beyond normal retirement age.
- Individuals face material investment and longevity risks over their lifetimes. Careful thought should be given to how such risks are best managed and, where possible, mitigated.
- The net return earned on retirement savings over long accumulation periods has a major impact on the savings rate required to produce a target pension. Specifically, low net returns imply high required savings rates.
- The actual cost experience of managing retirement savings in Canada varies materially, ranging all the way from 0.2% per annum for large-scale public vehicles such as the CPP Investment Board to 2.0% per annum or more for many retail mutual funds.

As a "policy neutral" document, the Report did not discuss the policy implications of these findings. I am not similarly constrained.

Before setting out these policy implications, I noted above that Bob Baldwin was asked to conduct a separate study for Ontario on the capacity of Canada's retirement income system to produce adequate retirement income in the future. Many of Baldwin's findings parallel those in the Mintz Report. Baldwin's final conclusion is: *"The status quo is an option. However, it is an option that may leave a significant minority of people with moderate to high earnings facing a decline in their standard of living in retirement, and force many people to rely on sub-optimal pension and retirement savings institutions."*

Policy Implications

The policy implications of the Mintz and Baldwin Reports seem to me to be straight-forward:

- Don't fix what isn't broken.
- Zero-in on the areas where Canada can, and should do better:
 - get the middle/higher-income under-savers on the right savings track,
 - facilitate the proper management of investment and longevity risk for all Canadians, and
 - ensure all of Canada's retirement savings are managed in a cost-effective manner.
- This suggests that a mandatory major expansion of the CPP is not what Canada needs at this time. One size does not fit all. Instead, a more surgical approach should be taken, which focuses specifically on the three specific 'can, and should do better' areas of our retirement income system that the Mintz and Baldwin Reports identify.
- However, taking a more surgical approach does not mean leaving it all in the hands of the financial services industry to solve through 'competition'. A judicial pinch of collective action will be an essential pension reform success ingredient.
- Specifically, successful responses will meet the triple test of:
 - raising retirement savings rates for the target group of under-saving workers,
 - devising effective risk-mitigation strategies/techniques for retirement savers who need them, and
 - ensuring investment solutions are expert and low-cost at the same time.
- Creating responses that meet this triple 'effectiveness' test will require both political vision and leadership, and a co-operative approach between the public and private sectors.

That is the post-Whitehorse challenge as we enter the crucial year of 2010.

Leading the World

In my recent C.D. Howe Benefactors Lecture I noted that if we respond positively to the pension reform challenges lying ahead of us, Canada will attain #1 status in global pension design and delivery. To 'own the pension podium', we must now agree on a suite of pension reform measures that meet the triple effectiveness test set out above. The design of that suite should reflect three important lessons:

1. The lessons from behavioral finance research: While traditional economics (and economists) continue to assume economic actors who are rational and all-knowing, behavioral research studies suggest real humans suffer from bouts of indecision, overconfidence, choice overload, and incomplete knowledge. Thus pension design and delivery reform must create intelligent 'nudge' defaults such as auto-enrolment, and age-based investment and annuitization policies.
2. The lessons from institutional investment research: The Mintz Report wonders why active management continues to persist despite strong evidence that, on average, it costs more than the value it produces. The Baldwin Report provides a partial answer by noting that many

investment decision structures are unfocused and ineffective. In his 1936 opus *The General Theory* John Maynard Keynes called traditional active management “beauty contest investing”. Just last month, Jeremy Cooper, Chair of the Australian Pension Review task force, noted that the apex of the globe’s thought-leading pension funds appear to reside in Canada, and that they are moving beyond traditional active management into value-adding shareowner stewardship, and into private investment markets such as real estate and infrastructure. The pension reform implications are that all Canadian retirement savers should benefit from these thought-leading, built-in-Canada wealth-creating strategies.

3. The lessons from the 1990s CPP/QPP reform process: Just as the world admires Canada’s thought-leading pension funds, so do they admire the process through which we reformed the CPP/QPP in the mid-1990s. We identified the problem (unsustainable CPP/QPP), debated possible solutions, settled on the best option (increase the contribution rate, build a reserve fund, and create the CPP Investment Board), and implemented it in world-record time. Fifteen years later, we have identified an effectiveness/efficiency problem in the supplementary part of Canada’s pension system. Now the next steps are to identify the best possible solution to the problem, and to implement it. We have done this before, and we can do it again.

Let’s get on with it.