

**MAKING PRPPS WORK FOR WORKERS:
CANADA'S PENSION REFORM AGENDA FOR 2011****Keith Ambachtsheer**

March 1, 2011

As though RRSPs, RRIFFs, LIFFs, TSFAs, and RPPs weren't enough, Canada's Finance Ministers added yet another acronym to our pension lexicon at their pre-Christmas pension reform meeting in the Rockies. They announced that there was not sufficient consensus to proceed with expanding the Canada and Quebec Pension plans. Instead, they had instructed their officials to proceed with the development of the PRPP, short for Pooled Registered Pension Plan. What should Canadians make of this development? Are PRPPs the answer to Canada's emerging pension problems? Or just another wrong turn on our long road to pension reform?

First, is there a problem that PRPPs are supposed to solve? Yes, there is. While Canada's current mix of public pensions (OAS, GIS, C/QPP) provides high post-work income replacement for low-income workers, this is not the case for middle- and higher-income workers. Ideally, employment-based pension plans make up the difference for these workers, but statistics show that less than a quarter of private sector workers are members of such plans. So effectively, the majority of middle- and higher-income private sector workers in Canada are left to their own devices to figure out when to retire, and what they need to do to finance the post-work lifestyle they aspire to.

While Canada's financial services industry is keen to help out, that help typically comes at a high price in the form of various types of fees. While these fees may have been affordable in the good old days of double-digit investment returns, that is no longer the case in the current world of volatile, at best, single-digit returns. This is where the PRPP as a supplement to public OAS and CPP/QPP pensions comes in. Properly designed and implemented, PRPPs help middle- and higher-income Canadians without employment pension plans navigate their way through uncertain, volatile financial markets towards a retirement date and lifestyle that are, if not ideal, at least acceptable and not disastrous.

The catch of course is the "properly designed and implemented" qualifier. For PRPPs to be successful, they will require three critical features:

1. **Auto-enrolment:** research shows that people sometimes need a 'nudge' to do what is best for them. This is especially so in situations such as financing future retirement, where the realization of 'what is best' is not

tomorrow, but lies years, even decades into the future. However, auto-enrolment should not mean mandatory participation. There should be an opt-out provision. The power of auto-enrolment has been confirmed by US-based research which indicates that worker participation in 401(k) plans increases dramatically with auto-enrolment.

2. **A well-designed default option:** recent research from Australia indicates that in situations of investment option choice in retirement plans, 80% of workers choose not to choose. Instead, they tick off the default option box, effectively leaving it to the employer or pension service provider to choose on their behalf. This reality makes it essential that all PRPPs have a well-designed default option with respect to contribution rate, investment policy, post-work decumulation policy, and cost effectiveness.
3. **Independent, expert oversight:** with the dual requirements of auto-enrolment and a well-design default option, it follows logically that PRPPs should be subjected to an independent, expert oversight discipline. This discipline should encompass both the initial PRPP approval and ongoing value-for-dollars monitoring phases. Ideally, there is a single pan-Canadian oversight body, possibly operating as an arm of CAPSA (Canadian Association of Pension Supervisory Authorities). Fortunately, the working party of federal-provincial officials labouring on the PRPP file is well-aware of these three critical requirements.

Will all this come to pass? In my view, the odds are better than 50-50. On the demand side, many individual Canadian workers know they need a nudge to get them on an achievable target retirement date/standard of living track. Knowledgeable groups ranging from the Canadian Federation of Independent Business, to the Canadian Association of Retirement Persons, to the Canadian Labour Congress also recognize something constructive needs to be done. On the supply side, the Canadian insurance and pension industries have welcomed the PRPP concept in principle. All this makes the PRPP concept a winner with our federal and provincial elected officials too, with the political upside far outweighing the downside. So the next Finance Ministers meeting in June could be a legacy-maker for the attendees. It could be the meeting where the next chapter in Canada's retirement income systems begins.

Keith Ambachtsheer

Keith Ambachtsheer is President of KPA Advisory Services Ltd., a strategic advisor to 'thought leading' pension funds around the world, and co-founder of CEM Benchmarking Inc., which benchmarks the organizational performance of many of the globe's major pension funds. Both firms are based in Toronto. He is also Director of the Rotman International Centre for Pension Management at the University of Toronto.