



PENSION PAPERS

## Saving Pooled Registered Pension Plans: It's Up To the Provinces

By

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- The federal government's Bill C-25 provides for a new type of tax sheltered savings plan for Canadians called a pooled registered pension plan (PRPP). In its current form, however, the design blueprint falls short of its primary objective: to ensure that the majority of Canadians who do not have a workplace pension will have access to a well-regulated, low-cost, private sector capital accumulation plan.
- Provincial leadership is required to breathe life into the federal legislation, by requiring employers to offer PRPPs to employees, and provide well-thought-out default options and an independent PRPP licensing system.

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Canada's pension reform debate has led to a broad consensus that the private component of the Canadian pension system needs shoring up. Millions of private-sector workers employed by mid-sized or smaller firms, as well as the self-employed, are not members of employment-based pension plans. As a result, many of these workers will have difficulty maintaining their standards of living when they cease employment in the decades ahead. Two possible solutions to this problem have emerged. Some think the answer is to expand the universal target-benefit-based Canada/Québec Pension Plans. Others think the goals of improved coverage, portability and reduced costs can be achieved with a more nuanced approach – a new low-cost, fit-for-purpose group savings plan to be offered through employers. Over the last year, the key design features required for such a Pooled Registered Pension Plan (PRPP) solution have been debated inside governments and by Canada's academic and financial services communities.

### *Bill C-25 and the PRPP Solution*

On November 17, the federal government took a step toward addressing the problem with the introduction of Bill C-25, which “creates a legal framework for the establishment and administration of pooled registered

pension plans that will be accessible to employees and self-employed persons pooling funds in members' accounts to achieve lower costs in relation to investment management and plan administration.”<sup>1</sup> Bill C-25 envisions the following key design features:

- PRPPs could be offered by any corporation approved by the Office of the Superintendent of Financial Institutions (OSFI), which would have the power to issue PRPP licenses (Sections 10-13).
- PRPP administrators – which are distinct from employers – would be subject to a “prudent person” standard of care. They would be required to offer PRPP participants a menu of risk/reward investment choices, as well as a default option. They would also be required to manage the PRPP “at low cost” and provide participants with PRPP account values on a regular basis (Sections 14-26).
- PRPP administrators would set the contribution rates (Section 45).<sup>2</sup>
- Decisions by employers to offer their employees' access to a PRPP and by employees to participate would be voluntary (Section 27).
- PRPP contributions would be locked-in except in cases of disability or death (Section 47).
- Provinces would be able to override any Bill C-25 feature and will need to introduce enabling legislation to make PRPPs available where employment relationships are governed by provincial law (Sections 5-9).

### *Can Bill C-25 Solve Canada's Pension Coverage Problem?*

Bill C-25, while providing a framework, has yet to address the three key policy challenges posed by Canada's pension coverage problem:

1. *Maximizing PRPP Participation:* Voluntary employer PRPP participation, as envisioned in the bill, will result in minimal actual PRPP uptake.
2. *Default Option Design:* Bill C-25, in its current form, is virtually silent on the important questions of PRPP default option design, which most participants would either choose or default into.
3. *Fiduciary Oversight:* Saying PRPPs should be “low cost” and leaving PRPP regulation to current, cumbersome regulatory processes would not directly address potential conflicts of interest and informational asymmetry between enrolled workers and PRPP administrators.

Now it's up to the provinces – both in terms of informing the regulations<sup>3</sup> with appropriate features and in determining the basis on which the provinces will participate. We expand on each of these issues below.

### *Maximizing PRPP Participation*

Maximizing PRPP participation requires the design of an effective enrollment protocol that applies to all workers in Canada who are not members of an employment-based pension plan. Requiring employers to enroll their employees in a PRPP is not a radical departure from current pension practices – employers are already required to enroll their workers (and the self-employed to enroll themselves) in the Canada/Québec Pension Plans. Québec has taken the lead on this issue, indicating that every employer will be required to offer a PRPP and every Québécois with work income (including the self-

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1 Purpose of Bill C-25 as stated in the Bill's preamble and in Section 3.

2 It isn't clear why a PRPP should be less flexible than current pension rules allow – this one-size-fits-all approach seems unnecessary.

3 Draft legislative proposals for changes to the *Income Tax Act* and the Income Tax Regulations to accommodate Pooled Registered Pension Plans (PRPPs) can be accessed at: <http://www.fin.gc.ca/n11/11-134-eng.asp>.

employed) will have access to one.<sup>4</sup> For its part, Bill C-25 would require employers to enroll full-time employees (who would be able to opt out) should the employer voluntarily decide to offer a PRPP.

A new requirement for employers to offer a PRPP, as we suggest, would place an additional burden on mid-sized and small business employers, so some form of *quid pro quo* for these employers to act might be part of the PRPP implementation package.<sup>5</sup> This could take the form of a modest one-time incentive payment for employers (or enrollment tax credit) per employee who remains “contributed” for a period of time.

The other critical enrollment protocol design element is the opt-out process for employees who do not wish to participate. Under Bill C-25, auto-enrolled full-time employees can opt out within 60 days of enrollment, a period slightly longer than that of New Zealand’s KiwiSaver program which offers newly auto-enrolled workers a two- to eight-week window to opt out. KiwiSaver also allows workers to take contribution holidays (within limitations) if they choose to stay in the program, a critical feature which appears to be provided for in Bill C-25. While the design of the default option should include a matching employer contribution, employers should also have an opt-out option as envisioned in Bill C-25.<sup>6</sup> Further, although pre-retirement access to PRPP funds should be limited, the restricted access proposed in Bill C-25 would be unfair to low-income workers and could be a significant deterrent to participation.

### *Default Option Design*

As most PRPP participants will either choose or default into a plan’s default option, its design is critically important. Recent Australian research suggests that acceptable designs should meet certain minimum requirements.<sup>7</sup>

The default option must have a contribution model that is logical and transparent. One of us has proposed a default contribution rate of 10 percent (ideally, split 50-50 between employees and their employer) on annual income between \$30,000 and \$100,000.<sup>8</sup> Such a calculation requires making assumptions about the target post-work income replacement rate, the continuation of Canada’s public pension system, working-life length, post-work longevity, investment returns, and contribution rate ceilings. Dodge, Laurin, and Busby (2010) calculate required contribution rates in the 7 to 21 percent range for middle- and higher-income workers, depending on the target income replacement rate and pre-retirement income levels. A contribution rate structure that starts low for young workers and automatically scales up with age is another design feature that should be considered.

On the investment side, these requirements should focus on the design of both the retirement savings accumulation and post-work decumulation phases. For example, PRPP administrators should be able to explain how their investment programs integrate a factor such as employee age into their accumulation and decumulation paths. Another should be the administrators’ view on making dynamic adjustments to the default offering based on changing capital-market conditions and material deviations from the funding target required to produce a target pension. The availability (or absence) of annuity options should also be addressed.<sup>9</sup>

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4 Bachand (2011).

5 Many employers already offer Group RRSPs – PRPP arrangements needn’t be more burdensome and may be an attractive alternative.

6 The choice to contribute must be with the employer. However, in a competitive labour market, new employer pension contributions simply replace increases in current compensation and the goal of fostering the steady accumulation of retirement savings is still accomplished.

7 See Sy (2011) and Cooper (2010). The Superannuation Legislation Amendment Bill 2011 proposes to introduce a low-cost default superannuation product.

8 See Ambachtsheer (2008). Exempting from auto-enrollment those with income below \$30,000 would reflect the value of OAS and GIS benefits relative to income.

9 For example, Ezra (2011) argues that an ‘advanced life deferred annuity’ is an attractive alternative to the traditional life annuity.

Cost-effectiveness should be a default option design theme. The PRPP administrator should be able to demonstrate that its default offering has been designed with a “value for dollars” mindset – both with respect to the investment management and the plan administration elements of the offering. This does not mean that cheaper is always better. Rather, there should be a transparent link between the fees that participants pay and the quality of the services they receive. PRPP administrators should be required to commit to providing transparent “value for money” information on a regular basis.

### *Fiduciary Oversight*

Effective oversight can best be delivered by an independent, expert PRPP licensing body with ongoing “value for money” monitoring responsibilities.

Can the federal, provincial and territorial governments agree to a dedicated agency, thus avoiding the complex jurisdictional morass that characterizes pension regulation in Canada today? There is precedent for reaching such an intergovernmental agreement in the CPP/QPP reforms of the 1990s that led to the creation of the CPP Investment Board.

The same type of co-operative process should be used to create an independent PRPP Licensing Board to provide oversight of PRPP administrators and the products they offer. Its mandate would be to ensure that PRPPs serve the financial interests of members of such plans. Such a Board should have the following features:

1. *Roles, Responsibilities and Activities:* In discharging its mandate, the Board would be authorized to:
  - develop the attributes of a PRPP delivery structure that would provide the best mix of competence, innovation, scale economies, and competitive behavior in the design and delivery of PRPP services to all Canadian workers without pension plans;
  - license PRPP administrators<sup>10</sup> that meet prescribed requirements and reflect the attributes of the desired PRPP delivery model for Canada;
  - develop properly structured duties for administrators, focused on the circumstances of plan participants and oriented to long-term, wealth-creating investing;
  - develop and monitor “value for dollars” reporting requirements for PRPP administrators;
  - hold public hearings to ensure PRPP plan members and their representatives have a voice in the design and delivery of PRPPs; and
  - establish a license review process to permit new PRPP administrators to receive licenses and to deny license renewals of PRPP administrators not meeting PRPP value for money standards.
2. *Organization Structure:* The Board would be governed by a competent, credible board of directors with the collective skill and experience to put in place the protocols and staff needed to achieve its mandate.<sup>11</sup>
3. *Financing:* While repayable government funding will be required in the startup phase, the Board should eventually be self-financing through modest deductions from PRPP contributions.

Bill C-25 contemplates OSFI carrying out these licensing and oversight responsibilities. While this is not impossible, it would be a new and somewhat different role for OSFI. The provinces would also have to cede regulatory authority to it.

### **Where to from Here?**

The message of Bill C-25 is that Ottawa wants – and the provinces should take– significant ownership of the PRPP project, particularly with respect to the issues described above. This makes sense given the need for federal-provincial coordination

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<sup>10</sup> In contrast to a typical pension plan, the administrator will be the entity offering the PRPP, rather than the employer.

<sup>11</sup> The CPPIB provides a good model for director selection.

and will be required to enable PRPPs to become part of the solution to Canada's pension coverage problem. Once the issues noted above (as well as tax issues)<sup>12</sup> have been addressed, an implementation task force can be mandated to focus on the details.

The financial fate of millions of Canadian workers without pension plans is now in provincial hands. We encourage them to take up the challenge.

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12 While we argue that provincial government leadership is now critical, there are steps the federal government could be taking as well. For example, the *Income Tax Act* could accommodate our suggestion for dynamic adjustments by increasing the annual limits on tax-deferred savings or moving to a lifetime limit as advocated by Pierlot (2011).

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