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# Fiscal Pulse

## Pooled Registered Pension Plans

### ... A Proposal to Broaden Canada's Retirement Savings Options

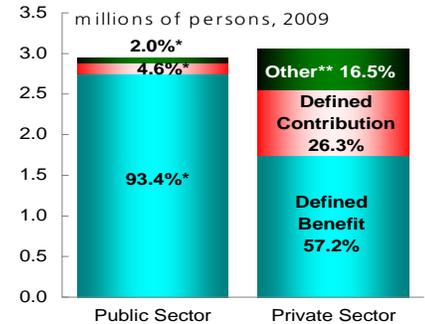
At the federal/provincial/territorial Finance Ministers' meeting, broad agreement was reached for a new type of defined contribution pension plan, a Pooled Registered Pension Plan (PRPP). Following the introduction of the Tax Free Savings Account, the PRPP will further broaden Canadians' savings options and offer a targeted response to the large number of self-employed and private-sector workers currently without access to a workplace Registered Pension Plan (RPP). If Canadian governments make PRPPs mandatory for employers without RPPs, this new vehicle could result in a sizeable pool of savings.

The treatment of PRPPs under the *Income Tax Act* will be aligned with defined contribution<sup>1</sup> RPPs and Registered Retirement Savings Plans (RRSPs). A distinguishing feature of a PRPP is a third party's assumption of the administration and investment functions for a pool of retirement assets. Regulated financial institutions capable of assuming a fiduciary role (i.e. trust and insurance firms and other financial institutions with a trust subsidiary) will carry out these functions: assuming responsibility for a PRPP's management; offering its members a range of investment options; undertaking the day-to-day administration; and communicating regularly with members.<sup>2</sup>

#### Meeting the needs of private-sector workers without an RPP

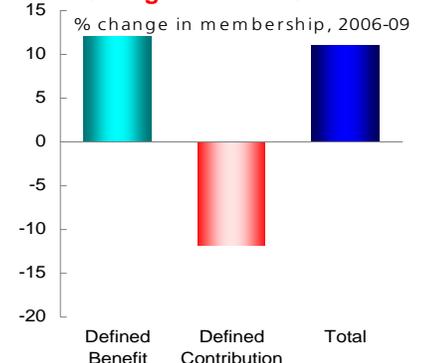
- While public-sector workers are largely covered by defined benefit RPPs, among private-sector workers membership in defined benefit plans has declined by 18½% from 2006 to 2009, and more than 70% of private-sector paid employees have no RPP coverage. Research on retirement income adequacy has identified a growing number of middle-income workers, without access to an RPP, who will not be able to replace the targeted 60%-70% of their pre-retirement income after they leave the labour force. Conversely, employers, especially small- and mid-sized firms, are reluctant to take on the expense and risks of establishing their own pension plans as they struggle to sustain competitive costs.
- For an employer, a key advantage of a PRPP over an RPP is that the third-party administrator assumes most of the administrative tasks. The employer's responsibilities are, therefore, limited to selecting a plan, enrolling its employees, determining employer and employee contribution levels and collecting and remitting regular contributions. Importantly, an firm may be required to provide a PRPP, but it does not have to make contributions. This flexibility addresses the concern that fixed charges related to payrolls typically discourage hiring, particularly when Employment Insurance premiums, paid by employers and employees, are expected to rise over the next few years.<sup>3</sup>

#### Registered Pension Plan (RPP) Membership

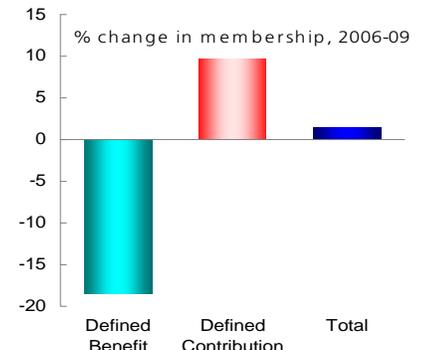


\* Per cent share of sector membership.  
 \*\*Includes hybrid & composite plans.

#### RPP Changes - Public Sector...



#### ... and Private Sector



Source: Statistics Canada.

<sup>1</sup> In tax legislation, a defined contribution RPP is termed a 'money purchase' plan.

<sup>2</sup> A PRPP administrator's reporting requirements will include annual statements outlining investment performance and relative risks, fees and other costs, each member's retirement income with an annuity purchase, and plan amendments.

<sup>3</sup> CPP contributions (employer plus employee) climbed from 3.6% of pensionable earnings in 1986 to 6.0% in 1997 to the current 9.9% rate in 2003.

- ❑ PRPP features such as default enrolment — all employees are automatically enrolled in an employer's PRPP but can opt out — plus regular payroll deductions from pre-tax income are expected to boost participation by middle class workers. Past experience indicates that a large share of middle-class households do not take full advantage of their RRSP contribution room, with workers finding voluntary, lump sum contributions from after-tax income difficult for RRSPs and Tax Free Savings Accounts.
- ❑ The critical factor for PRPPs is whether each Province and Territory, faced with both employees' and employers' needs, will make PRPPs mandatory for at least some employers who currently offer no RPP.

#### Responding to the needs of the self-employed

- ❑ A PRPP will have two classes of members: Employed Members participating through their employer's plan; and, Individual Members that will include the self-employed or employees with no access to an RPP. Investments will be pooled across all members.
- ❑ Individual members will choose their own PRPP, set their own regular payroll deductions and choose whether to make an additional lump sum contribution, in accordance with their RRSP limits.

#### A PRPP's investment advantage

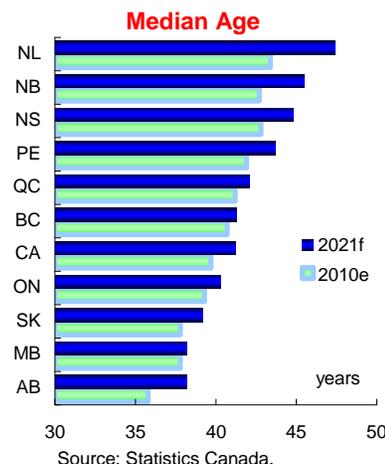
- ❑ For individuals without an RPP, a large-scale pooled pension plan offers an accessible, transparent savings option that provides increased diversification, lower administration costs and access to professional investment management. For financial institutions, PRPPs offer a significant new market opportunity, likely accompanied by stepped-up competition on items such as investor services and fees.
- ❑ Impacting the efficiency and effectiveness of PRPPs will be the extent of regulatory harmonization adopted by the federal and provincial governments. Greater harmonization will facilitate larger-scale plans across the country, effectively lowering unit costs per member.

#### Portable PRPPs should underpin labour mobility

- ❑ Portability features of a PRPP will be similar to an RPP's portability for Employed Members, with fewer restrictions for Individual Members. Transfers will be possible between plans, possibly subject to an administrator's minimum investment period. In a broader context, the option of a PRPP might encourage public- and private-sector employees with RPPs to follow new opportunities, including self-employment, thereby enhancing workforce flexibility.
- ❑ To ensure that PRPP assets are available for retirement income purposes, employer contributions will be locked in, but some jurisdictions may choose to allow employees to unlock a portion of their savings under specific circumstances such as financial hardship.

#### The potential growth of PRPPs

- ❑ Considerable discussion and debate on PRPPs is now required to finalize the details for this latest retirement savings vehicle. A relatively expeditious development and implementation phase would yield significant benefits given the approaching retirement of an outsized baby boom generation across Canada. The PRPP does not preclude other options, such as an expanded Canada Pension Plan (CPP) that was supported by six Provinces or the development of a voluntary, supplementary CPP.
- ❑ The introduction of a PRPP is expected to highlight other issues, such as the need to raise annual contribution limits for defined contribution pension plans and RRSPs well beyond the scheduled increases after 2010 related to average wage and salary growth in order to establish a more level retirement savings field between employees with defined benefit RPPs and all other workers. In the near-term, however, the impact of PRPPs depends largely upon each Province's decision on making them mandatory for firms without RPPs.



#### Scotia Economics