

INTO THE HOME STRETCH: TIME TO CHOOSE THE WINNING PENSION REFORM HORSE

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A Critical Juncture

This brief sets out our up-to-date views on the pension reform derby, a month before the Finance Ministers next meet on this topic in Alberta.

There is now wide consensus that the primary target of pension reform should be the millions of Canadian middle-income, private sector workers who do not have an employer-sponsored Registered Pension Plan. Many in this group face the risk of suffering material declines in their living standards when they retire. Two lead reform horses have emerged to address this looming problem:

1. Expand the CPP/QPP through raising the YMPE (currently \$47,200), or raising the income replacement rate (currently 25%), or some combination of the two.
2. Expand supplementary pensions through a viable strategy that will enroll the target group into one or more cost-effective pension plans or retirement savings accumulation arrangements that would sit on top of the current public OAS/GIS/PPP/QPP pension mix.

In our view, pension reform in Canada has now reached a critical juncture, which we state boldly below. In short, the time has come to choose the winning pension reform horse.

Two New Research Papers and a New Consultation Initiative

This 'time to declare a winner' view crystallized as we read the two most recent additions to the now-impressive collection of accumulating Canadian pension reform studies. IRPP (Institute for Research in

Public Policy) published Patrik Marier's *Improving Canada's Retirement Saving: Lessons from Abroad, Ideas at Home* in September. It was followed in October by the University of Calgary's School of Public Policy's publication of Jon Kesselman's *Expanding Canada Pension Plan Benefits: Assessing the Big CPP Proposals*.

As advertised, the Kesselman paper focuses almost entirely on horse #1: fleshing out the CPP expansion proposals that have surfaced to date. In contrast, the Marier paper focuses almost entirely on horse #2: how other countries have shaped strategies to supplement their basic public pension programs. Together, the two papers offer Canada's policy-makers the luxury of assessing new insights into both possible approaches to addressing Canada's middle-income, private sector workers pension coverage problem. However, as we state boldly below, the overriding assessment goal must now be to reach a decision whether to back horse #1 or horse #2.

Meanwhile, on the consultation front, the Ontario Government has launched a new consultation initiative. Perhaps not surprisingly, the consultation document asks respondents a number of specific questions related to both reform horses #1 and #2, as well as about which horse they would prefer to ride.

The Marier Paper Contribution

The value of understanding how other countries (New Zealand, Norway, Sweden, and the United Kingdom) have addressed the challenge of enhancing coverage and benefits through supplementary pension arrangements is self-evident. Marier discovers however, that the value of these lessons is limited. A strong element of multi-decade, path-dependency runs through each of

Time to Choose the Winning Pension Reform Horse

The time has come to choose the winner between the two leading pension reform horses. Why? Because each of the two approaches represents a feasible, but inherently complex design, implementation, and communication challenge on its own. Trying to do 'some of each' may seem politically attractive, but would be unacceptably risky as a practical proposition. The super-complexity that would result from choosing a dual-track approach involving riding both pension reform horses would risk torpedoing the fruits of the years of research and debate that have gotten us to this point.

the four country pension reform stories. In each case, the specifics of the chosen solution were heavily influenced by what came before, and by the country's social-cultural fabric.

For example, Marier points out that Norway's decision to mandate employers to provide adequate pension arrangements for their employees required the kind of robust national government-business-labour bargaining process that does not exist in Canada. In the case of Sweden, the big pension reform story was to move to a mandatory, self-adjusting, national, pay-go defined contribution scheme. Adding on the small AP7 personal accounts piece was almost an afterthought. The two countries with a more Anglo-Saxon orientation (NZ and UK) have neither Canada's CPP/QPP equivalent, nor a history of mandating participation in large occupational pension schemes. This led both countries towards designing 'soft compulsion' personal pension account arrangements on a national basis, with features such as auto-enrolment, auto-investment, and auto-contribution escalation.

So it is not surprising that the models of the Saskatchewan Pension Plan, and that province's Co-operative Superannuation Society Pension Plan, offer the best 'fit' for reforming Canada's retirement income system (other than through CPP/QPP expansion). They operate independent from government, and offer good governance and operations mechanisms. Naturally, considerable re-design would have to be done for one of them (or some blend of the two) to operate on a multi-provincial or national level. Also, Marier stresses the need for Canada to carefully consider the role that 'soft compulsion' devices such as auto-enrolment should play to ensure broad, pan-Canadian participation in a much-expanded version of a SPP/CSSPP type-of supplementary pension arrangement. Finally, Marier points out that there is always the challenge of reaching consensus on the way ahead within Canada's unique decentralized political structure.

The Kesselman Paper Contribution

Kesselman's most important contribution is to carefully set out the various approaches to expanding the CPP/QPP (and their implications) in the greatest detail done to date. By doing this, he raises a number of important issues that have remained largely off the pension reform radar screen thus far. For example:

- ◆ Taking an integrated approach to pension reform through CPP/QPP enhancement offers an opportunity to have a look at the functionality of the OAS and GIS components of Canada's retirement income system as well. For example, a larger CPP benefit could eliminate the need for the tax-funded

OAS benefit altogether, and force a closer look at the purpose and design of the GIS.

- ◆ Considerable equity and efficiency benefits to expanding both the CPP/QPP benefit level and the earnings coverage level (i.e., the YMPE) could be garnered. For example, employers would be able to worry less about pension design and delivery, and instead focus on producing greater value in their for- or not-for-profit organizations. Most employees would receive higher, more secure, more portable pensions. The self-employed would also be brought into this common national pensions-fold.
- ◆ Significant scale and expertise on both the investment and administration sides of the pension 'business' should lead to higher levels of long-term investment and pension delivery performance.
- ◆ With careful design, intra-generational longevity risk and intergenerational investment timing risk could be more efficiently borne, to the benefit of all.
- ◆ The value of different approaches to design enhancements should be explored. For example, rather than making enhanced CPP/QPP participation mandatory, could it be based on the 'soft compulsion' principle of auto-enrolment with an opt-out option?

None of these to-date under-explored considerations necessarily makes the reform option of expanding the CPP/QPP the odds-on favorite to win the Canadian pension reform derby. It does, however, make it a more serious contender than many people have thus far thought.

Choosing

So which pension reform horse should Canadians ride to victory? Is it enlightened CPP/QPP enhancement? Or is it a sound strategy leading to much wider participation in one or more well-managed, low-cost pension arrangements that supplement Canada's current public OAS/GIS/PP/QPP structure? In our view, either strategy, properly designed and implemented, could propel Canada from its current 5th place ranking (according to the Melbourne Mercer Global Pension Index) in the global pension excellence derby to #1. But we must choose. Trying to ride both reform horses to victory would be a losing proposition for all Canadians.

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