

SPPG Policy Institute Talk – Jan 28 2015
On
DESIGNING RESILIENT PENSION POLICY

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I am the only speaker without a talk title.....what to do with this freedom opportunity?

Two Things

1. 'ICPM -> quick world tour on 'designing resilient pension policy'..... (at least, my version of it!)
2. Then two Canada-specific thoughts -> 1. New Brunswick's 'shared risk' pension initiative.....and 2. Ontario's 'ORPP' initiative

Topic #1: International Pension Tour

- ICPM Fall 2009 Forum happened to be in Melbourne.....became launching pad for the MM Global Pension Index
- Designed by David Knox/Mercer colleagues..... annual release of GPI scores.....newsworthy event.... Overall pension system quality score is composite of 3 sub-index scores for system adequacy, sustainability, and integrity.....0-100 range...
- MMGPI covered 11 countries in 2009.....25 countries in 2014
- Does the MMGPI tell us anything useful?for me....yes -> Top Quartile, Second Quartile, Bottom Half

Top Quartile

- 5 Northern European Countries + Australia....scores....82 -> 73
- 4 Common characteristics: 1. Sustainable Pillar 1, 2. Mandatory pre-funded Pillar 2, 3. Small Pillar 3, and 4. Strong pension institutions and regulation.

Bottom Half

- Mainly developing countries....India, Indonesia, China, Brazil, SA, Mexico.....but also France, Italy, Japan...scores 57 -> 44
- 4 Common characteristics: 1. Unsustainable Pillar 1, 2. Fragmented Pillar 2, 3. Fragmented Pillar 3, and 4. Weak pension institutions and regulation.

Second Quartile

- Includes Canada, UK, and (barely) USA....scores 69 -> 58
- 4 Common Can/UK/USA characteristics: 1. Sustainable Pillar 1, 2. Bi-polar Pillar 2 (i.e. mandatory public sector DB plans/voluntary private sector DC plans), 3. Significant, high-cost Pillar 3 components, 4. Mix of strong/weak pension institutions and regulation.

Overall Conclusions

- Remarkable diversity among national pension systems (even among 'developed' economies!)
- High scores driven by 1. Sustainable Pillar 1, Mandatory, prefunded Pillar 2, and 3. Strong pension institutions and regulation.

Topic #2: Getting Canada into the Top Quartile?

- Two things would do it: 1. Modernize the remaining traditional DB plans into DA/TB plans, and 2. Vastly increase pension coverage and intermediation efficiency in the private sector.

Addressing DB Plan Modernization Challenges

- 'Old' DB model: final earnings/inflation indexed/ancillary benefits/fully employer-guaranteed.....looked affordable with young workforce, high GDP growth/high investment return economies/stable longevity
- Affordable no longer: more retirees, older workforce, weaker growth/returns/rising longevity, stronger solvency and disclosure requirements -> large private sector employers from DB -> DC
- 'New' DA/TB model: career average/conditional indexation/fewer ancillary benefits/risk bearing shifted to workers/retireesthese transitions can be done well....or badly.....
- Transition Challenges: trust/fairness issues, property rights clarity, simplicity over complexity Example: NB -> 'Dutch 'shared-risk' modelwhile the Dutch have decided -> 'our model is not working!' -> serious redesign discussions -> KPA paper on this topic....happy to share....

Addressing Private Sector Coverage/Intermediation Efficiency Challenges

- Continuous coverage decline -> RPP coverage down to 20% -> 2 problems: 1. Inadequate savings 2. Inefficient savings -> Public Policy issue? Response #1: 'NO' Response #2: 'YES'
- I am in the 'YES' camp --> 2008 CDHowe Paper "The CSPP: Towards an Adequate, Affordable Pension for ALL Canadians" -> Simple idea: Low-cost, targeted retirement savings plan with an annuitization back-end that sits on top of the existing OAS/ CPP plans
- 2014....ORPP.... could be that basic ideaOr not.....some see ORPP as a stalking horse for an expanded CPP.....
- In my view.....trying to integrate the ORPP into CPP would not be a good idea -> the complexity of such a venture is vastly underestimated....
-as just one example.....: full prefunding of benefits now required..... Costed at what return assumption??? Surely not at net 4% real??? Who would underwrite the shortfall risk??? Surely not our children???
- Finalizing ORPP Pension Design not only remaining challenge.....qualifying alternative plans? Integration with alternative plans? Income range covered? ORPP legal/governance structure? ITA/CRA compliance?
- In short, ORPP -> A brave, ambitious project with a very short timeline and considerable implementation risk....

In Conclusion

- High-quality Retirement Income Systems have three key components: 1. Sustainable Pillar 1, 2. Mandatory/Nudge, prefunded Pillar 2, and 3. Strong pension institutions and regulation....
- Canada could join the globe's pension elite countries by doing 2 things: 1. Enhancing the sustainability/transparency of its existing Pillar 2 plans, and 2. Providing vastly-broader Pillar 2 plan coverage for its private sector workforce... ..