Federal government moves forward on Pooled Registered Pension Plans

(August 2011)

The subject of retirement funding is on a lot of minds these days. The first of the baby boomers, born in 1945, hit the traditional retirement age of 65 in 2010, and that milestone has pushed to the forefront the question of how financially prepared Canadians are for retirement.

Traditionally, retirement at the age of 65 was marked by receipt of the first of (hopefully) many monthly cheques from the pension plan into which the new retiree had contributed for decades. But that's not today's reality. Many employed Canadians do not, in fact, belong to a pension plan and many more who do have seen those plans significantly altered over the past couple of decades.

To understand the changes, a bit of background is required. Private retirement savings (distinct from government programs like Canada Pension Plan or Old Age Security) come in two basic forms—registered retirement savings plans (RRSPs) and registered pension plans (RPPs). An RRSP can be set up by any working Canadian taxpayer, and a tax deduction claimed for contributions made to that plan. Under current laws, however, only an employer can create an RPP for its employees. Deductions are made from an employee's salary or wages and contributed to the pension plan in his or her name. The employer also makes a contribution to the plan on behalf of each employee. Those contributions are combined and invested to create the pool of capital which will be used down the road to provide a retirement pension for the employee.

Within the general category of RPPs, however, there are two very different types of plans. Both are funded by means of employer and employee contributions, but there the similarity ends. The first type of plan, the increasingly rare "defined benefit" plan, is now mainly the prerogative of public sector employees. Under a defined benefit plan, the employee is guaranteed pension benefits at a specified level (sometimes also indexed to inflation). Where plan assets, for whatever reason, fall short of the amount necessary to provide benefits at that level, the employer is responsible for making up any shortfall. Under the second type of RPP, the "defined contribution plan", there is no guarantee with respect to the amount of pension benefit which will be available to the employee. Employee contributions and employer contributions are combined and invested over the employee's working life and the total amount accrued is available to the employee when he or she retires, to structure in the way he or she chooses to provide a stream of retirement income.

While it is clearly better to belong to a defined benefit plan than a defined contribution plan (and many Canadians have seen their defined benefit plans converted to defined contribution plans or group RRSPs over the past decade or so), the concern which has arisen over the past few years is for those Canadians who don't have access to a pension plan of any kind. Those Canadians can, of course, contribute to an RRSP, but statistics show that most Canadians are simply not contributing to RRSPs and therefore not accumulating retirement savings in amounts sufficient to provide for a comfortable retirement.

The federal and provincial governments have concluded that part of the solution to this problem lies with a new vehicle for retirement savings known as Pooled Registered Pension Plans (PRPPs).

What PRPPs represent, essentially, is an opportunity for Canadians who do not currently have access to an employer-sponsored RPP to join a pooled defined contribution plan with others in the same position. There are many reasons why an individual might not have access to a employer-sponsored RPP. The self-employed, of course, immediately come to mind, but even Canadians who are employed by a company may not have the option. Setting up and administering a registered plan, and managing the investment of funds in such a plan is an expensive, time-consuming and specialized undertaking. Many small companies do not have the expertise or resources to do so and the cost of retaining professionals to manage an employee pension plan is not cost-effective where the number of employees is small. The idea behind PRPPs is that a third party administrator would take on most of the responsibility that employers usually bear with respect to RPPs, but would do so for not one but for many employers and self-employed taxpayers who would pool their contributions into, and share the costs of, a single plan.

Finance officials from the federal and provincial governments met at the end of 2010 to consider the possible structure of PRPPs. Following that meeting, a backgrounder outlining the framework for such plans was issued, from which the following details are taken:

- There will be two classes of members eligible to participate in PRPPs. Employed members will include employees of an employer who chooses to offer a PRPP and individual members will include the self-employed and employees of an employer who does not offer a PRPP. While investments will be common across all members, there will be some administrative and regulatory differences between the two classes of members.
- Where an employer chooses to provide a PRPP, the employees of that employer may be enrolled in the plan. Individual members will make their own choice as to whether to join a PRPP. Where an employer does provide a PRPP, employees can be enrolled in that Plan at any point during their employment, not just when they are first hired.
- An employer who chooses to provide a PRPP will be responsible for selecting the particular Plan in which his or her employees will be enrolled and for effecting that enrollment. The employer will determine the level of employee contributions and will be responsible for collecting and remitting those contributions.
- Employers may—but are not required to—make direct employer contributions to the PRPP on behalf of the employees, as is done in a traditional RPP.
- Member benefits under PRPPs will be portable—that is, employees will be able to move their assets under the Plan to another Plan when they change employers, or they may elect to stay with the same Plan, despite changing employers. There will be some restrictions on portability, but fewer such restrictions will apply to individual members.
- There will be “locking-in” provisions with respect to employer contributions to a PRPP, similar to those which apply under current pension standards legislation. As is currently the case, some jurisdictions may permit withdrawal of employer contributions under specified circumstances, which usually include financial hardship.
- PRPPs will be administered, and funds invested, by a third-party administrator, which will generally be a regulated financial institution. While assets invested under a PRPP will be pooled for investment purposes, each plan participant will have a personal account and will receive annual statements which outline investment performance, costs and fees, and the amount of contributions made (broken down between employer and employee), as well as an illustration of the level of retirement income which could be generated through the purchase of an annuity, given the member’s existing plan assets.

As is the case with any defined contribution pension plan, the plan participant will have access to an amount at the time of retirement, comprising his or her own contributions, employer contributions (where applicable), and amounts generated by the investment of those contributions. The plan participant will then need to decide how to structure or invest that amount in order to create a stream of retirement income.

Most aspects of pensions, including the rules governing their creation and administration, and the investment decisions involved in managing them, are complex. The goal of PRPPs is to provide Canadians, largely the self-employed and employees of small and medium sized companies, with access to the expertise needed to set up and administer such plans, on a cost-effective basis.

More information on PRPPs can be found on the federal government Web site at http://www.fin.gc.ca/activty/pubs/pension/prpp-irpac-eng.asp. The Minister of State for Finance is currently engaged in a consultation process with affected stakeholders across Canada with respect to PRPPs and more information will undoubtedly be forthcoming at the end of that consultation process.