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Doin' the PRPP Walk

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The Harper government has introduced legislation to allow the PRPP, the Pooled Retirement Pension Plan (pronounced Perp), sort of a group RRSP for small businesses. The idea is that employees can have voluntary contributions deducted from their pay, and the employers may, or may not, if so inclined, also make some contribution to the employees' pensions. Pension managers, such as one of the big banks or other regulated financial institution would then manage the funds contributed by the employees and their employers, thereby providing economies of scale and other efficiencies.

No surprise, the idea immediately generated the usual reactions from the usual sources. The Canadian Taxpayers Federation (CTF) immediately praised the move, saying that it was such a great idea, that it should be immediately mandatory for all new government employees and for MPs, to boot. Yeah, I'm holding my breath waiting for that one. Let's see, your average MP has a fully-indexed, gold-plated pension that's fully vested after only 6 years (you only have to get re-elected once, and your golden years will be, er, golden), and the CTF, bless 'em, thinks the Honorable Member will toss that for half of a defined contribution plan? It's a nice thought, but short of MPs being forced to accept it by angry mobs with torches and pitchforks, it'll never happen.

Also unsurprisingly, the regulated financial institutions - banks, brokers, insurers, pension managers, financial planners, mutual fund companies – also thought the idea was terrific. More business for them, more fee income – what's not to like?

The NDP, naturally, thinks the idea sucks almost as much as the stock market does these days. They call it "rolling the dice" with Canadians' retirement savings. They'd rather see higher taxes, er, higher CPP contributions taken off your pay, which the employer has to match. That's not an option for many small businesses, especially start-ups, so as usual, the self-described defenders of the "working man" favour policies that will cost jobs at the margin. La plus ca change. Equally unsurprising, the Canadian Labour Congress (CLC) and organized labour think the plan is little more than a "piecemeal approach" that is basically just an income generator for the evil financial institutions.

And the big criticism, of course, is that the plan is pretty much useless. Canadians can already contribute to low-cost voluntary pension plans. They're called Registered Retirement Savings Plans (RRSPs), and Canadians are avoiding them to the tune of $600 billion or thereabouts in unused contribution room already. Still, the PRPP is harmless enough. It won't be a drain on the public purse: there's no source of "tax leakage" here like with those diabolical income trusts a few years back. In theory, the system may provide the discipline that some people need to start saving for their retirement, but then, they could just as easily be having money deducted from their pay and deposited into an RRSP.

And sure, it's indeed rather a timid step towards pension reform, a subject I'd just as soon not get embroiled in here, as it is so boring that I'd be face down on my keyboard faster than a politician can jump on a dumb idea. Let me just direct the interested reader to a study by the Brookings Institute that looked at national retirement savings plans in Australia, the UK, New Zealand and Chile. (http://www.brookings.edu/papers/2009/07_retirement_savings_john.aspx) All four have innovative features and all are bolder and far more comprehensive than the PRPP, so there's no shortage of models to mine for ideas. None of them is perfect, but there are a lot of good features that are worth a look. So, while the PRPP is a timid step to be sure, it is at least a step in the right direction.

On the other hand, and much as it pains me to agree even tangentially with the CLC, the government is indeed "rolling the dice" with your retirement savings. Oh, not in the way that the CLC suggests, of course.

It's not the PRPP that's rolling the dice with your retirement savings, though. There are other forces at work doing that. There's the Bank of Canada, for one, obligingly keeping interest rates at - what's Governor Carney's phrase again? Oh yeah - "extraordinarily stimulative levels." That plays havoc with retired Canadians living on fixed incomes from their retirement savings, who are faced with rolling over maturing Guaranteed Investment Certificates (GICs) and fixed-rate instruments at lower yields that no longer provide enough income to live on, forcing them to move further out the risk spectrum, rolling the dice by chasing high-yield bond funds and increasingly esoteric Exchanged Trade Funds (among other things). Thankfully, the big domestic banks are there, obligingly willing - nay, keen to help out by giving you a Home-Equity Line Of Credit (HELOC). I was gob-smacked to learn recently that HELOCs, as they used to call these loans in the US a few years ago, until they blew up in everyone's faces, have become the most competitive area in Canadian retail banking, with the big banks jostling each other to encourage Canadian consumers to use their homes as ATMs and live large, or at least, to dump the proceeds into said bank's mutual funds, the better to provide for your retirement.

Has no-one learned anything from the crisis? That's merely a rhetorical question, of course, because, alas, apparently nobody has, least of all governments, but that's a whole 'nother rant.

So the Bank of Canada, like most of its other central bank confreres around the world, is keeping interest rates at crisis levels in order to keep stimulating a stimulus-addicted economy. It's as if the economy is your cousin with the crystal meth problem, and instead of an intervention and sending him to rehab, you give him a big bag of crank and a six-pack of Red Bull. Yeah, that'll work.

The real downside of all this is that it is penalizing the prudent. That's right, the kind of behavior that we need more of in society – living within your means, not getting buried in debt, saving for your own retirement – is being penalized by low interest rates. Given our aging boomer demographics, this seems like a policy that's tailor-made to make the pension problem even worse than it would otherwise be. And don't even get me started on Governor Carney's tut-tutting over the high levels of consumer debt that Canadians are carrying, or, even more disingenuously, his finger-wagging about the rising cost of housing. Doh? What do you think happens when you keep interest rates at "extraordinarily stimulative" levels? Debt is so cheap they're almost giving it away, so it shouldn't be a surprise that consumers are loading up on the stuff. Similarly, with such low rates, you can carry a bigger mortgage, so housing prices get bid up. Jack rates up a point or so, and watch how fast consumers deleverage and how quick the steam goes out of the housing market. Just last spring, in fact, when expectations were that the Bank of Canada's next move would be to hike rates, consumers were already starting to deleverage and pay down their mortgages and other loans. But that frisson of hawkishness passed, and now we're again back to expecting even lower rates ahead, so party on Dudes, and how about a HELOC?

Meanwhile, the federal and provincial governments also are doing their part. They took the well-worn Keynesian path in response to the global financial crisis, spending billions on stimulus and generating big honking deficits in the process, deficits that, mirabile dictu, need extraordinarily low interest rates for extended periods of time (and we're talking geological timescales, here folks) in order to be carried.

The upshot of all this is that, for the next decade or so, developed economies are looking at returns on fixed income in the 2% to 3% range, and returns on equity investments of 4% to 6%. That kind of makes the actuarial assumptions of many pension plans in both public and private sectors just a tad overoptimistic, and thus likely to be continually under-funded at present contribution levels. Insurance companies are already getting killed on their annuities business because of these lower returns. Oddly enough, I noted that during this year's Grey Cup Game broadcast there was a steady stream of ads from the life companies advertising life annuities for retirement-minded boomers. You know, the ones where the kids complain that Mom and Dad now get a cheque every month for life and they're (Gasp!) contemplating buying scooters!

I may be missing some nuance here, and I'm sure I'll be hearing about this in some angry emails from someone in the life insurance business, but it looks like the life insurance companies are advertising heavily to drum up even more of the annuity business that they're already losing money on due to low interest rates. I guess they plan to make it up on the volume. Actually, they're losing money on annuities they wrote back when interest rates still made sense because they can't finance them anymore at today's nonsensical interest rates, so maybe they're just trying to drum up new business at today's vastly lower annuity rates in order to average down. You know, like people who were long Nortel at $120 a share did all the way down to $1. That worked a treat, didn't it?

Corporate pension plans are also being negatively impacted by our current "extraordinarily stimulative" interest rate. I keep hearing the guests on the Stock Porn Channel jabber on about all the cash on corporate balance sheets, which will sure come in handy when all those corporations have to make up for their pension fund deficits.

Anyway, that's enough about the problem. PRPPs, while innocuous enough, won't do much to solve those pension/retirement problems in this country. Here're a couple of suggestions for a bolder fix.

First, cherry pick the best ideas out of the New Zealand, Chile, UK and Australian experiences.

Second, let's take another look at RRSPs. When RRSPs were first established, the idea was that your savings could compound tax-free until you retired, and then they'd be taxed as income when you withdrew the money, but that would be OK, as you'd be retired and in a lower tax bracket anyway. How's that workin' for you? In my 40-odd years of work, my marginal tax rate has dropped from a high of 53% (Bob Rae's Ontario workers' paradise, lest you forget) to around 48% now. The government still basically takes half of what I make, and I doubt that percentage will change much when I retire and start drawing down my RRSP. Here's an idea, then. Why not allow a certain amount to be transferred from an RRSP to a Tax Free Savings Account (TSFA) every year, without triggering a tax liability? That would go a long way to making the retirement savings of Canadians go a lot further, and in a much more efficient fashion than the PRPP, too.

Further, why not increase the allowable annual contribution to a TSFA? It's money you've already paid taxes on, so the only loss to the government is money they get from double-taxing you anyway, the elimination of which, to borrow an NDP phrase here, is only social justice. Plus for young people today, who are going to be (thanks again to extraordinarily stimulative interest rates and the inverted pyramid of Boomer demographics) expected to pay through the nose for the retirement of the generation ahead of them, the TSFA is a far superior instrument for accumulating a retirement nest egg than is an RRSP. Or it would be if there was more contribution room.

Finally, let's go back to that C$ 600 billion in unused RRSP contribution room. I have suggested this in the past, as a Swiftian sort of policy idea, but the idea increasingly bears thinking about: why not allow people who cannot use all their RRSP contribution room to sell some of it to those who could use more RRSP room? They could use the proceeds – and you could make it a requirement that the proceeds from such a sale could only be used in this way - to make a TSFA or RRSP contribution of their own, or even to pay down a mortgage or student loan. It wouldn't take Bay Street more than a day or so to figure out a way to make a market in unused RRSP room that people could trade.

This will never happen, of course. Politicians – secure in the knowledge that we'll be paying for their gold-plated indexed pensions (fully vested after 6 years) forevermore – will never give us anything near the retirement freedom to which they know they are entitled. Instead, they'll continue to give us more of the same ineffectual reforms as always, things like increasing the allowable RRSP contribution room, which costs nothing because we can't use the contribution room we have already. Or things like the PRRP, which while harmless, is only marginally helpful.

Perhaps a necessary first condition to achieving any meaningful kind of pension reform, with a nod to the CTF, is for our political masters to have to rely on the same kinds of pensions that we do. As long as their pensions are ever so much more equal than ours, as Mr. Orwell might have out it, there's little hope of ever seeing any real improvement in our ability to provide for our own retirement years. Get them in the same leaky pension boat with the rest of us, and watch how fast they start helping out with the bailing.

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