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The VRSP solution: How Canadians can save more for their retirement

Quebec's Voluntary Retirement Saving Plan system is for those who do not have access to a group retirement savings plan with source deductions through their employer

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On the macro scale, there is no force as powerful as demography. Canadians are getting older, have not saved enough for their retirement and are thus more exposed to longevity risk, which is broadly defined as the risk of outliving one's savings. All of these factors, we believe, make the state of Canada's pension system one of the most pressing issues on the public scene.

But this is far from being solely a Canadian problem. The public debate about pensions is at the forefront pretty much everywhere throughout the developed world. Canada is actually doing a very good job of taking care of its elders, with only 4.4 per cent having income lower than half of median income as of 2005, well below the Organization for Economic Co-operation and Development average of 13.3 per cent (see chart). But the situation could quickly get worse if nothing is done to get Canadians to save more than they currently do.

Retirement systems are usually divided into three components, commonly called "pillars." The first one consists of government pensions (for Canadians, the Canada Pension Plan), the second of workplace pensions (which are either defined benefit or "DB" plans, defined contribution or "DC" plans, or a mix of the two) and the third of personal savings (your accumulated wealth via RRSPs or the equity on your home, for example).

Associated with these pillars are three challenges: people are living longer, the retirement age is constantly falling (leading to a lower active-to-retired ratio) and the markets are not helping as interest rates remain stubbornly low and the stock market has been volatile. Most importantly, the average Canadian is undersaving and, more broadly, the coverage of workplace pensions is not high enough at only 24 per cent over all, compared to 87 per cent in the public sector (nearly the same coverage as in the U.S.).

An interesting – and dare we say necessary – solution adopted by the Quebec government last year is called the Voluntary Retirement Saving Plan, or VRSP, which will actually become a reality on July 1 of this year.

VRSPs are group savings plans offered by employers and administered by authorized administrators, such as insurance companies. They are mainly for employees who do not have access to a group retirement savings plan with source deductions through their employer.

This type of solution is not completely new. The U.K. has a similar plan where the assets are managed by Nest, a public entity.

One of the most important features of the VRSP is that employees will not have to take any action to sign up: enrolment is automatic. Self-employed workers and other individuals will also be able to sign up for a VRSP, which addresses the issues of coverage (broader access) and delivery head-on since the solution remains in the private realm.

VRSPs can be seen as a means for every Quebecker not already covered by a private pension to gain access to a DC plan, encouraging them to save more and ultimately to reduce their dependence on the government. Some technical issues still remain to be ironed out, but this is a promising first step.

The most crucial step to help fix the lingering pension deficit problem is to thus to nudge working-age individuals to save more. To that end, many experiments have shown that mandatory enrolment with an opt-out provision, as opposed to an opt-in approach, is a very powerful tool to do the trick. The U.K. has seen impressive results, with participation jumping from 30 per cent to 92 per cent simply by framing the choice differently, and we can only hope that VRSPs lead to a similar result.

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