
National Institute on Ageing

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September 25, 2018

The Hon. William Morneau
Minister of Finance
and
The Hon. Filomena Tassi
Minister of Seniors
House of Commons
Ottawa, Ontario
K1A 0A6

Re: Enhancing the efficiency of retirement income options for older Canadians

Dear Ministers,

We, the undersigned organizations, believe that while Canada's retirement income system works well in many ways, there continue to be opportunities to help Canadians achieve financial security and peace of mind well into advanced ages.ⁱ

This letter identifies one such opportunity: to help millions of Canadians maintain their standard of living for as long as they live by making collective longevity risk pooling arrangements available to all Canadians. To that end, we propose measures that could be enacted quickly, and with no material cost to government. While we expand on some of our views and their implications in the endnotes to this letter, we are also prepared to work with your officials to identify the specific legislative and regulatory adjustments required to implement the measures we propose below.

Increases in Longevity and Addressing the Risk of Outliving One's Money

Your government's focus on the welfare of the millions of Canadians transitioning into their retirement years is evidenced by the recent appointment of a new Minister of Seniors, your leadership in working with the provinces to enhance the Canada Pension Plan (CPP), and the 2016 increase to Guaranteed Income Supplement (GIS) for the lowest income seniors.

The current and future needs of seniors present an opportunity to further help millions of Canadians maintain their standard of living for as long as they live. For the first time in Canada's history, there are more people over the age of 65 than under the age of 15. 2011 was the year baby boomers started turning 65, leading to the largest increase (20%) in the senior population in 70 years. Conversely, Canada's overall population growth was 5% from 2011 to 2016 and the population of children grew by only 4.1%.ⁱⁱ

In 2016, seniors aged 85 and older made up 2.2% (or over 770,000) of the population; by 2031 as the oldest boomers reach 85 this cohort is set to increase to 4% (or over 1.25 million) and by 2051 as the youngest boomers reach this milestone it is set to increase to 5.7% (or about 2.7 million)ⁱⁱⁱ. The rapid expected increase in seniors aged 85 and over requires a robust range of income options to address longevity in the very near future.

These Canadians face uncertainty in financing their retirement years. While actuarial tables provide expected life durations, few Canadians actually die in the year the tables predict. This creates uncertainty and a material financial risk of outliving one's money. A frequent response is to reduce expenditures on the necessities of life, thereby creating or enhancing estate values at the expense of the quality of life for Canada's elderly.

Fortunately, this observed variance in longevity creates a natural risk pooling opportunity between those who die early and those who outlive their life expectancy. Longevity insurance based on this risk pooling principle can play a valuable role in the lives of individual Canadians and their families, as well as in the Canadian economy at large.

At the individual level, longevity insurance removes the worry of outliving one's retirement money. At the macro-economic level, it ensures Canadian seniors can contribute to maintaining aggregate demand and hence national employment levels and economic growth by consuming goods and services at rates that maintain their standard of living during their later retirement years. Without more efficient retirement income options, Canadian seniors' inability to cover the necessary expenses later in life will put greater stress on families and communities – in addition to an already burdened healthcare system – and will create greater dependency on federal and provincial income-support programs.

Making Longevity Insurance Available to All Canadians

Given its individual and collective value, longevity insurance is embedded in national income support programs such as Old Age Security (OAS), the Quebec Pension Plan (QPP), and CPP.^{iv} It is also embedded in workplace defined benefit (DB) pension plans. However, there has been a steady shift in Canadian workplaces away from DB plan coverage towards defined contribution (DC) pensions, Group Registered Retirement Savings Plan (RRSP)/Tax-Free Savings Account (TFSA) coverage, or no coverage at all. In total, out of 19 million working Canadians, only 4.2 million are members of a workplace DB pension plan.^v And even for those who have DB plans, short employment service may mean the DB pension provides inadequate lifetime income.

Thus, millions of Canadian workers are increasingly left to design and implement their own retirement finance strategies. As increasing numbers of Canadians move toward retirement, designing and implementing effective decumulation strategies takes on increasing importance.^{vi}

Designing Effective Decumulation Strategies

What do effective decumulation strategies look like? At the individual level, logic and research suggest people should want, and actually do want, their decumulation strategies to achieve two key goals:

1. Provide withdrawal flexibility in their early retirement years
2. Assure secure payment continuity in their later retirement years

Achieving these two goals efficiently means having easy access to decumulation strategies with:

- A front-end income drawdown protocol to provide the flexibility Canadians want^{vii}
- A back-end longevity protection mechanism to provide the income-for-life assurance they need^{viii}

At the individual level, decumulation strategies are usually executed within the Registered Retirement Income Fund (RRIF) legal structure with its minimum annual withdrawal rules. We believe Canadians should be able to acquire longevity protection through their RRIFs and TFSAs with insurance company-provided late-life deferred life annuity contracts. For example, such a contract could be purchased at age 65, with payout commencing at age 85 providing constant payouts until death.^{ix} To minimize the tax deferral implications of this option, the purchase amount could be capped in relative and absolute terms.^x

Collective longevity risk pooling arrangements integrated with collective DC pensions and Group RRSP/TFSA plans should also be an option available to Canadians. Such an arrangement could be initiated by an employer or by a financial services provider. Due to existing pension and income tax rules, neither the individual nor the collective option to acquire longevity insurance is available to most Canadians today.

Barriers to Acquiring Longevity Insurance

There are three current barriers to acquiring longevity insurance:

1. To employer or other group-sponsored collective solutions with DC pensions or Group RRSP/TFSA components: an employer-sponsored collective payout program that pools longevity and investment risk already exists in Canada. The University of British Columbia's Variable Payout Life Annuity (VPLA) came into force in 1967 and has operated successfully since.^{xi} A key feature is that the amount of the annuity payout can vary, depending on the plan's investment and mortality experience. From an Income Tax Act (ITA) perspective, it was legal as "an arrangement acceptable to the Minister". However, a 2004 change to the Income Tax Regulations removed the Canada Revenue Agency's discretion to approve such arrangements after 2003. The current law effectively blocks employers or other entities from setting up VPLA-type group arrangements for their employees.
2. To late-life deferred annuity contracts: current ITA rules prevent individuals from purchasing a deferred life annuity with their registered savings with a benefit commencement date beyond the end of the year they attain age 71. Raising the allowable commencement age for a deferred life annuity up to age 85 would allow individuals to cost-effectively manage their longevity risk and use their other retirement assets to provide an income until age 85.^{xii}
3. Non-annuitization rules in TFSAs: the liquidity requirements of the ITA currently do not allow for the purchase of locked-in life annuities (immediate or deferred) in TFSAs, which are increasingly used as a means to partially secure sustainable retirement income. Allowing TFSAs to purchase immediate or deferred (up to age 85) life annuities could further aid retirees in managing longevity risk without having any material impact on tax revenues.

Fortunately, these barriers can be easily removed at no material fiscal cost:

1. For the collective employer or other entity-sponsored option: amend the Income Tax Regulations that prevent the creation of new collective variable payout programs that allow professional investment management and pool longevity risk.^{xiii}
2. For deferred annuity contracts: change the ITA by increasing the permissible commencement age for registered life annuities from 71 to age 85 from registered plan assets. (It should be clear that payments from registered pension plans, RRSPs, RRIFs and registered annuities are only taxed as received).
3. For Tax-Free Savings Accounts: change the ITA to allow TFSAs to invest in immediate or deferred (up to age 85) life annuities.

The signatories to this letter respectfully request that these actions be taken as soon as possible. All three actions could benefit many of the over 14 million working Canadians who will otherwise have inadequate lifetime income in retirement and need options to address longevity risk, as well as to the Canadian economy as a whole through the enhanced confidence and ability of seniors to maintain their standard of living as they age.

We, the undersigned, look forward to initiating a dialogue with you and your officials on the most effective ways for Canadian workers to acquire longevity insurance so that they can maintain their standard of living as long as they live.

Yours truly,

Ric Marrero, Chief Executive Officer

Association of Canadian Pension Management (ACPM)
The voice of the Canadian retirement income industry.

Wanda Morris, Chief Advocacy and Engagement Officer

Canadian Association of Retired Persons (CARP)
With over 300,000 members, the voice of older Canadians, advocating for better healthcare, enhanced financial security, and freedom from ageism and abuse for older adults.

John Dark, President

Canadian Institute of Actuaries (CIA)
The national organization of the actuarial profession in Canada.

Stephen Frank, President and Chief Executive Officer

Canadian Life and Health Insurance Association (CLHIA)

The organization representing life and health insurance providers in Canada.

Alex Mazer, Founding Partner

Common Wealth

Mission-driven company focused on expanding access to retirement security.

Keith Ambachtsheer, Director Emeritus

International Centre for Pension Management, Rotman School of Management, University of Toronto.

Michael Nicin, Executive Director

National Institute on Ageing (NIA)

A think tank on cross-disciplinary thought-leadership, innovative solutions and policies related to aging, based at Ryerson University.

Brenda King, Chair

Pension Investment Association of Canada (PIAC)

An organization that promotes sound investment practices and good governance for the benefit of Canadian pension plan sponsors and plan members.

CC: The Hon. Diane Lebovillier, Minister of National Revenue

References and Discussion Notes

ⁱ See Bonnie-Jeanne MacDonald's 2018 paper "Headed for the Poorhouse: How to Ensure Seniors Don't Run out of Cash before They Run out of Time" published by the C. D. Howe Institute. (<https://cdhowe.org/public-policy-research/headed-poorhouse-how-ensure-seniors-don%E2%80%99t-run-out-cash-they-run-out-time>).

And David Don Ezra's 2018 paper "Making the Money Last: The Case for Offering Pure Longevity Insurance to Retiring Canadians," published by the C.D. Howe Institute. (https://www.cdhowe.org/sites/default/files/attachments/research_papers/mixed/Final%20Commentary_521.pdf)

ⁱⁱ Statistics Canada, (<https://www150.statcan.gc.ca/n1/daily-quotidien/170503/dq170503a-eng.htm>).

ⁱⁱⁱ Statistics Canada, (<http://www12.statcan.gc.ca/census-recensement/2016/as-sa/98-200-x/2016004/98-200-x2016004-eng.cfm>).

^{iv} The latest starting payout age under OAS, QPP and CPP is currently 71. The C.D. Howe Institute released a paper showing the potential value of raising the latest starting payout option to age 75. See (<https://cdhowe.org/public-policy-research/deferring-receipt-public-pension-benefits-tool-flexibility>).

^v Statistics Canada, (<https://www150.statcan.gc.ca/n1/daily-quotidien/170721/dq170721d-eng.htm>).

^{vi} See ACPM's 2017 study "Decumulation: The Next Critical Frontier," ([https://www.acpm.com/ACPM/media/media/resources/7/media/AGR/Publication/Decumulation-Improvements-for-DC-and-CAP-\(27-Mar-17\).pdf](https://www.acpm.com/ACPM/media/media/resources/7/media/AGR/Publication/Decumulation-Improvements-for-DC-and-CAP-(27-Mar-17).pdf)).

^{vii} We noted that the Registered Retirement Income Fund (RRIF) is a good example of such an income drawdown instrument. The minimum withdrawal rules were last adjusted in 2015. The C.D. Howe Institute's study by Robson and Laurin argues further adjustments are needed: See "Drawing Down our Savings: The Prospects for RRIF Holders Following the 2015 Budget," (<https://cdhowe.org/public-policy-research/drawing-down-our-savings-prospects-rrif-holders-following-2015-federal-budget>).

^{viii} Immediate life annuities are not a popular choice for most Canadians, as they lead to a loss of withdrawal flexibility and loss of control of capital. For more on this see, Bonnie-Jeanne MacDonald's 2018 paper "Headed for the Poorhouse: How to Ensure Seniors Don't Run out of Cash before They Run out of Time" published by the C. D. Howe Institute. (<https://cdhowe.org/public-policy-research/headed-poorhouse-how-ensure-seniors-don%E2%80%99t-run-out-cash-they-run-out-time>).

This 2-instrument framing is also supported by recent research findings of the UK-based NEST organization, as reported in an Investment Magazine (Australia) article titled "UK's NEST Defaults to Flexibility on Retirement Income Product." See (<https://investmentmagazine.com.au/2018/04/uks-nest-defaults-to-flexibility-on-retirement-incomes/>).

^{ix} This option is available in the United States – for more details see the 2014 announcement by the U.S. Department of the Treasury titled "Treasury Issues Final Rules Regarding Longevity Annuities." See (<https://www.treasury.gov/press-center/press-releases/Pages/jl2448.aspx>).

^x Without appropriate limits, collective longevity risk pooling increases tax deferral. We are neither calling for nor taking a position on tax deferral in relation to such arrangements and look forward to working with government to address such related issues.

^{xi} See the UBC Faculty Pension Plan website (<http://faculty.pensions.ubc.ca/>) for further information on the VPLA.

^{xii} For an assessment of the fiscal impact of taxing deferred annuity income only when it is actually received, a recent study judges the likely overall fiscal impact to be "relatively small," and largely related to a reduction in precautionary over-saving that results from an inability to effectively manage longevity risk. See Kosarenko (2017) "Fiscal Impact of Permitting Late-Life Deferred Annuities," (<https://drive.google.com/file/d/0B-ABkf0rQgf5WjA2WWFUbzE4QIU/view>).

^{xiii} As is the case in the cited UBC Plan, we would expect this variability to be modest rather than excessive. The payout would vary according to the collective experience of the group of retirees who elect the variable option, according to the investment and mortality experience.